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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 6

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SUSAN DWIGHT BLISS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 23, 1934

CERTIORARI GRANTED APRIL 30, 1934

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SUSAN DWIGHT BLISS

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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1 Before United States Board of Tax Appeals

Docket No. 58391

SUSAN DWIGHT BLISS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket entries

Appearances:

For Taxpayer: Donald Arthur, Esq.

For Commissioner: C. C. Holmes, Esq.

1931

May 9—Petition received and filed. Taxpayer notified. (Fee paid.)

" 11—Copy of petition served on general counsel.

June 18—Answer filed by general counsel.

July 1—Copy of answer served on taxpayer. General Calendar.

Oct. 20—Motion to file amended petition, amended petition tendered, filed by taxpayer.

" 23—Motion to file amended petition granted.

" 27—Copy of motion and amendment served on general counsel.

Nov. 6—Answer to amended petition filed by general counsel. Copy served November 10, 1931.

1932

Sept. 8—Motion for leave to file amended answers, amendment tendered, filed by general counsel.

" 12—Motion granted.

" 20—Hearing set November 14, 1932.

2 Nov. 14.—Hearing had before Mr. Morris, division 14 on merits. Stipulation of facts filed. No briefs. Referred to Mr. Trammell.

Dec. 2—Findings of fact and opinion rendered, Mr. Trammell, division 2. Judgment will be entered under Rule 50.

" 29—Notice of settlement filed by general counsel.

1933

Jan. 5—Hearing set January 25, 1933, on settlement.

" 18—Consent to settlement filed by taxpayer.

" 31—Decision entered, Mr. Trammell, division 2.

Mar. 1—Petition for review by United States Circuit Court of Appeals (2) with assignments of error filed by taxpayer.

" 31—Proof of service filed by taxpayer.

" 31—Præcipe filed—proof of service thereon.

Before United States Board of Tax Appeals

Docket No. 60709

SUSAN DWIGHT BLISS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket entries

Appearances:

For Taxpayer: Donald Arthur, Esq.

For Commissioner: C. C. Holmes, Esq.

3

1931

Dec. 1—Petition received and filed. Taxpayer notified. (Fee paid.)

" 1—Copy of petition served on general counsel.

1932

Jan. 4—Answer filed by general counsel.

" 5—Copy of answer served on taxpayer. General Calendar.

Sept. 8—Motion for leave to file amended answer filed by general counsel, amended answer lodged.

" 12—Motion granted.

" 20—Hearing set November 14, 1932.

Nov. 14—Hearing had before Mr. Morris, division 14, on merits—no briefs—stipulation of facts filed—referred to Mr. Trammell.

Dec. 2—Findings of fact and opinion rendered, Mr. Trammell, division 2. Judgment will be entered under Rule 50.

" 29—Notice of settlement filed by general counsel.

1933

Jan. 5—Hearing set January 25, 1933, on settlement.

" 18—Consent to settlement filed by taxpayer.

" 31—Decision entered, Mr. Trammell, division 2.

Mar. 1—Petition for review by United States Circuit Court of Appeals (2) with assignments of error filed by taxpayer.

" 31—Proof of service filed by taxpayer.

" 31—Præcipe filed—proof of service thereon.

4 Before United States Board of Tax Appeals

[Title omitted.]

Petition (*No. 58391*)

Filed May 9, 1931

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue (respondent herein) in his notice of deficiency (IT:AR:A–1–MH–60D) dated March 10, 1931, and as a basis of the proceeding alleges as follows:

1. The petitioner is a resident citizen of the United States whose address is % Price, Waterhouse & Co., 56 Pine Street, New York, N.Y.

2. The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on March 10, 1931.

3. The taxes in controversy are income taxes for the calendar year 1928, in the amount of $1,909.31.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

5 (a) The respondent has failed to allow as a deduction in the computation of taxable income received by the petitioner from the George T. Bliss Agency account, $1,508.89 representing a part of the fees paid to the trustees.

(b) The respondent has failed to allow as a deduction in the computation of capital net gain, $12,454.97 loss on the sale of capital stock of Quincy Mining Company.

5. The facts upon which the petitioner relies as the basis of its appeal are as follows:

a. For the calendar year 1928 the petitioner filed Federal income tax return on or before March 15, 1929, on the basis of cash receipt and disbursements and the respondent has computed the tax liability of the petitioner on the same basis.

b. In the tax return filed by the petitioner, her taxable income from the George T. Bliss Agency trust was included in the entire amount either distributed or distributable to her. In the Treasury Department letter the amount of $1,508.89 has been added as representing a proportionate reduction of allowable deductions to the trust on account of fees paid to the trustees.

c. In the appeal of Grace M. Knox et al., Executors of the Estate of Seymour H. Knox (3 B.T.A. 143) it was held that such compensation to executor and trustees is one of the ordinary and necessary expenses of the estate and properly deductible *without regard*

6 *to the fact that a portion of the estate's income is exempt from taxation.* [Italics supplied.]

d. During the calendar year 1928, the petitioner sold capital stock of the Quincy Mining Company for $10,045.03 which at the date of receipt on October 30, 1918, had a cost or base of $22,500.00 resulting in capital loss of $12,454.97.

e. The respondent has failed to allow as a deduction in the computation of capital net gain the loss of $12,454.97, set forth in paragraph (d) above.

Wherefore, the petitioner prays that this Board may hear the proceeding and find that taxable income as computed by the respondent in his notice of deficiency is over-stated by $13,963.86, and that there is no deficiency in tax of the petitioner for the year 1928.

(Signed) DONALD ARTHUR,
Agent for Petitioner,
56 Pine Street, New York, N.Y.

[*Duly sworn to by Susan Dwight Bliss, jurat omitted in printing.*]

7 *Exhibit A to petition*

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington.

Miss SUSAN DWIGHT BLISS
(% Price, Waterhouse and Company),
56 Pine Street, New York, New York.

MADAM: You are advised that the determination of your tax liability for the year 1928 discloses a deficiency of $1,909.31 as shown in the statement attached.

8 In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D.C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; Whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,
Commissioner.

By (Sgd.) J. C. WILMER,
Deputy Commissioner.

Enclosures:
Statement.
Form 882.
Form 870.

9 Statement

IT:AR:A-1
MH-60D

In re: Miss Susan Dwight Bliss, % Price, Waterhouse and Company, 56 Pine Street, New York

Tax liability

Year	*Tax liability*	*Tax assessed*	*Deficiency*
1928	$64,290.84	$62,381.53	$1,909.31

The report of the internal revenue agent in charge at 250 West 57th Street, New York, New York, has been reviewed in connection with your protest dated November 23, 1929, and the report of the internal revenue agent in charge at 17 Battery Place, New York, New York, covering an examination of the books of account and records of the George T. Bliss Agency Account, % United States Trust Company of New York, 45 Wall Street, New York, New York, for the year 1928.

The dividends received from the Great Northern Iron Ore Company are held to be 35.71% taxable.

Net income reported on return:			
Ordinary net income			$226,241.49
Capital net gain			$207,850.82
Capital net gain as corrected			220,305.79
Increase			$ 12,454.97
10 Ordinary net income			$226,241.49
Add:			
1. Other income from George T. Bliss Agency account	$1,508.89		
2. Dividends received from the Great Northern Iron Ore Co	253.36		
			1,762.25
Adjusted net income			$228,003.74

Computation of tax

Adjusted net income		$228,003.74
Less:		
Dividends	$270,273.15	
Personal exemption	1,500.00	
		271,773.15
Income subject to normal tax		None
Surtax on $228,003.74		$ 37,260.75
Tax at 12½% on capital net gain of $220,305.79		27,538.22
Total tax		$ 64,798.97
Less:		
Tax paid at source		508.13
Tax assessable		$ 64,290.84
Tax previously assessed		62,381.53
Deficiency		$ 1,909.31

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Explanation of changes

1. Income from the George T. Bliss Agency account has been increased by $1,508.89 as fully explained by the revenue agent.

2. Dividends received from the Great Northern Iron Ore Company, which are held to be 35.71% taxable, have been included in the total income.

3. The amount of $12,454.97 claimed for loss on the sale of stock of the Quincy Mining Company has been disallowed, for the reason that information on file in this office discloses that no loss was incurred on the sale in the year 1928.

Due to the fact that the statute of limitations will presently bar any assessment of additional tax against you for the year 1928, the Bureau will be unable to afford you an opportunity under the provisions of article 1211 of Regulations 69 and/or article 451 of Regulations 74 to discuss your case before mailing formal notice of its determination as provided by section 274(a) of the Revenue Act of 1926 and/or section 272(a) of the Revenue Act of 1928. It is, therefore, necessary at this time to issue this formal notice of deficiency.

12 Before United States Board of Tax Appeals

[Title omitted.]

Amended petition (no. 58391)

Filed Oct. 23, 1931

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue (respondent herein) in his notice of deficiency (IT:AR:A–1–MH–60D) dated March 10, 1931, and as a basis of the proceeding alleges as follows:

1. The petitioner is a resident citizen of the United States whose address is % Price, Waterhouse & Co., 56 Pine Street, New York, N. Y.

2. The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on March 10, 1931.

3. The taxes in controversy are income taxes for the calendar year 1928, in the amount of $1,909.31.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

13 (a) The respondent has failed to allow as a deduction in the computation of taxable income received by the petitioner from the George T. Bliss Agency account, $1,508.89 representing a part of the fees paid to the trustees.

(b) The respondent has failed to allow as a deduction in the computation of capital net gain, $12,454.97 loss on the sale of capital stock of Quincy Mining Company.

(c) The respondent has failed to allow as a deduction in the computation of taxable income of the petitioner, the loss of $5,000.00 on investment in the capital stock of Stevenson & Cameron, Inc.

5. The facts upon which the petitioner relies as the basis of its appeal are as follows:

(a) For the calendar year 1928, the petitioner filed Federal income-tax return on or before March 15, 1929, on the basis of cash receipt and disbursements and the respondent has computed the tax liability of the petitioner on the same basis.

(b) In the tax return filed by the petitioner, her taxable income from the George T. Bliss Agency trust was included in the entire

amount either distributed or distributable to her. In the Treasury Department letter the amount of $1,508.89 has been added as representing a proportionate reduction of allowable deductions to the trust on account of fees paid to the trustees.

(c) In the appeal of Grace M. Knox et al., Executors of the
14 Estate of Seymour H. Knox (3 B.T.A. 143), it was held that such compensation to executor and trustees is one of the ordinary and necessary expenses of the estate and properly deductible *without regard to the fact that a portion of the estate's income is exempt from taxation.* [Italics supplied.]

(d) During the calendar year 1928, the petitioner sold capital stock of the Quincy Mining Company for $10,045.03 which at the date of receipt on October 30, 1918, had a cost or base of $22,500.00 resulting in capital loss of $12,454.97.

(e) The respondent has failed to allow as a deduction in the computation of capital net gain the loss of $12,454.97, set forth in paragraph (d) above.

(f) The petitioner invested $5,000.00 in the capital stock of Stevenson & Cameron, Inc. The capital stock of that company became worthless during the calendar year 1928 and the petitioner thereby sustained a loss on her investment of $5,000.00.

(g) The respondent has failed to allow as a deduction in the computation of taxable income, the loss of $5,000.00 set forth in paragraph (f) above.

WHEREFORE the petitioner prays that this Board may hear the proceeding and find that taxable income as computed by the respondent in his notice of deficiency is overstated by $18,963.86
15 and that there is an over-assessment of taxes for the calendar year 1928, in the amount of $949.34.

(Sgd.) DONALD ARTHUR,
Agent for Petitioner.
56 Pine Street, New York, N.Y.

AUGUST 13, 1931.

[*Duly sworn to by Susan Dwight Bliss, jurat omitted in printing.*]

16 [Exhibit A to amended petition (no. 58391) omitted. Printed side page 7 ante.]

17–19 [Omitted.]

20 Before United States Board of Tax Appeals

[Title omitted.]

Amended answer to amended petition (no. 58391)

FILED SEPT. 12, 1932

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, general counsel, Bureau of Internal Revenue, for amended

21 answer to the amended petition of the above-named taxpayer, admits, denies, and avers as follows:

1. Admits the allegations contained in paragraph 1.

2. Admits the allegations contained in paragraph 2.

3. Admits the allegations contained in paragraph 3.

4. Denies that he erred in determining the tax set forth in said notice of deficiency, and further denies that he erred as alleged in paragraphs 4 (a), 4 (b), and 4 (c) of the amended petition.

(d) Avers that the deficiency asserted in the notice of deficiency is understated by reason of the allowance of deductions for contributions in excess of 15% of the petitioner's "ordinary net income" before deducting contributions. Avers that in the event the Board determines that the petitioner's "ordinary net income" is less than the amount found by the Commissioner, the deductions for contributions should be limited to 15% of the "ordinary net income" before deducting contributions regardless of the amount thereof.

5. Denies any knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 5(a) to 5 (g) inclusive of the amended petition, and therefore denies the same.

6. The Commissioner relies on the following facts in support of the error assigned in subparagraph (d) of paragraph 4 hereof.

22 (a) In the notice of deficiency, the respondent determined that the petitioner's "ordinary net income" before deducting contributions was the sum of $270,490.77 and that petitioner had capital net gain in the amount of $220,305.79.

(b) In determining the "ordinary net income" set forth in the notice of deficiency in the amount of $228,003.74, the Commissioner made an allowance of $43,995.92, representing contributions claimed by petitioner.

Denies generally and specifically each and every material allegation contained in taxpayer's amended petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Board redetermine the correct amount of the deficiency involved in this proceeding to be equal to the amount determined by the Commissioner, plus any additional amount which may arise from the correction of any error or errors that may have been committed by the Commissioner. Claim is hereby asserted for the increased deficiency, if any, resulting from such redetermination.

(Signed) C. M. CHAREST,
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of counsel:
C. C. HOLMES,
Special Attorney,
Bureau of Internal Revenue.

k 9-2-32.

23 Before United States Board of Tax Appeals

[Title omitted.]

Petition (*no. 60709*)

Dec. 1, 1931

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue (respondent herein) in his notice of deficiency (IT:AR:A–2–MMB–60D), dated October 31, 1931, and as a basis of the proceeding alleges as follows:

1. The petitioner is a resident citizen of the United States whose address is % Price, Waterhouse & Co., 56 Pine Street, New York, N.Y.

2. The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on October 31, 1931.

3. The taxes in controversy are income taxes for the calendar year 1929, in the amount of $1,009.41.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

24 (a) In the computation of taxable income, the respondent has failed to allow as a deduction the $1,922.03 commissions paid on the collection of income.

(b) In the computation of taxable income, the respondent has failed to allow as a deduction $5,000.00 representing a loss on stock of Stevenson & Cameron, Inc.

5. The facts upon which the petitioner relies as the basis of her appeal are as follows:

a. For the calendar year 1929 the petitioner filed Federal income-tax return on or before March 15, 1930, on the basis of cash receipts and disbursements and the respondent has computed the tax liability of the petitioner on the same basis.

b. In the tax return filed by the petitioner, her taxable income from the George T. Bliss Agency trust was included in the entire amount, either distributed or distributable to her. In the Treasury Department letter taxable income has been increased by $1,653.93, representing fees paid to the trustees.

c. The taxpayer paid $268.10 commisisons on income collected by her agent. The Commissioner has disallowed this amount as a deduction.

d. In the appeal of Grace M. Knox et al., Executors of the Estate of Seymour H. Knox (3 B.T.A. 143), it was held that such compensation to executors and trustees is "one of the

37 ordinary and necessary expenses of the estate and properly deductible *without regard to the fact that a portion of the estate's income is exempt from taxation.*" [Italics supplied.]

e. The petitioner invested $5,000.00 in the capital stock of Stevenson & Cameron, Inc. The capital stock of that company became worthless during the calendar year 1929 and the petitioner thereby sustained a loss on her investment of $5,000.00.

Wherefore, the petitioner prays that this Board may hear the proceeding and find that taxable income as computed by the respondent in his notice of deficiency is overstated by $6,922.03 and that there is an overassessment in tax of $375.00 for the year 1929.

Respectfully submitted.

(Sgd.) DONALD ARTHUR,
Agent for Petitioner,
56 Pine Street, New York, N.Y.

NOVEMBER 20, 1931.

[*Duly sworn to by Susan Dwight Bliss, jurat omitted in printing.*]

Exhibit A to petition

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, Oct. 31, 1931.

MISS SUSAN DWIGHT BLISS
(% Price, Waterhouse and Company),
56 Pine Street, New York, New York.

MADAM: You are advised that the determination of your tax liability for the year 1929 discloses a deficiency of $1,009.41 as shown in the statement attached.

27 In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D.C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; Whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,
Commissioner.
By (Sgd.) J. C. WILMER,
Deputy Commissioner.

Enclosures:
Statement.
Form 882.
Form 870.

28 Statement

IT:AR:A-2
MMB-60D

In re: Miss Susan Dwight Bliss, % Price, Waterhouse and Company, 56 Pine Street, New York, New York

Tax liability

Year	*Tax liability*	*Tax assessed*	*Deficiency*
1929	$71,777.28	$70,767.87	$1,009.41

The report of the internal revenue agent in charge at 17 Battery Place, New York, New York, has been reviewed and approved by this office.

Computation of income

Ordinary net income reported on return		$213,483.37
Plus:		
a. Increase in fiduciary income	$1,653.93	
b. Increase in dividends	737.37	
c. Other deductions disallowed	268.10	
	$2,659.40	
Less:		
d. Profit on securities reduced	737.37	
		1,922.03
Ordinary net income adjusted		$215,405.40
29 Capital net gain reported on return	$294,942.31	
Plus:		
e. Increase in capital net gain	5,000.00	
		299,942.31
Total adjusted net income		$515,347.71

Explanation of adjustments

a. Income received from the Estate of George T. Bliss has been increased due to the disallowance as a deduction on the estate return, *commission paid on the collection of nontaxable income.*

b and d. Loss on the sale of 548 rights of Chicago and Northwestern R.R. Co. has been disallowed and this amount has been included as dividends.

c. Commissions paid on the collection of nontaxable income have been disallowed as a deduction.

e. Capital net gain has been increased by $5,000.00, this amount representing a loss on stock of Stevenson and Cameron, Incorporated, and disallowed for lack of sufficient evidence for the determination of the loss.

Computation of tax

Net income adjusted in revenue agent's report		$515,347.71
Less:		
Capital net gain		299,942.31
Income subject to surtax		215,405.40
Less:		
Dividends	$279,493.52	
Personal exemption	1,500.00	
		280,993.52
Balance subject to normal tax		None
Surtax on $215,405.40		$34,741.08
Tax at 12½% on capital net gain of $229,942.31		37,492.79
Total tax		72,233.87
Less:		
Income tax paid at source		456.59
Total tax assessable		71,777.28
Tax previously assessed		70,767.87
Deficiency		$1,009.41

Before United States Board of Tax Appeals

[Title omitted.]

Amended answer to petition (no. 60709)

Filed Sept. 12, 1932

31 The Commissioner of Internal Revenue, by his attorney, C. M. Charest, general counsel, Bureau of Internal Revenue, for amended answer to the petition of the above-named taxpayer, admits, denies, and avers as follows:

1. Admits the allegations contained in paragraph 1.

2. Admits the allegations contained in paragraph 3.

4a & b. Denies that he erred in determining the tax set forth in said notice of deficiency and further denies that he erred as alleged in paragraphs 4(a) and 4(b) of the petition.

(c) Avers that the deficiency asserted in the notice of deficiency is understated by reason of the allowance of deductions for contributions in excess of 15% of the petitioner's "ordinary net income" before deducting contributions. Avers that in the event the Board determines that the petitioner's "ordinary net income" is less than the amount found by the Commissioner, the deductions for contributions should be limited to 15% of the "ordinary net income" before deducting contributions regardless of the amount thereof.

5. Denies any knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 5(a) to

5(c) inclusive, of the petition, and therefore denies the same.

32 6. The Commissioner relies on the following facts in support of the error assigned in subparagraph (c) of paragraph 4 hereof:

(a) In the notice of deficiency, the respondent determined that the petitioner's "ordinary net income" before deducting contributions was the sum of $247,571.83 and that petitioner had capital net gain in the amount of $299,942.31.

(b) In determining the "ordinary net income" set forth in the notice of deficiency in the amount of $215,405.40, the Commissioner made an allowance of $39,088.46, representing contributions claimed by petitioner.

Denies generally and specifically each and every material allegation contained in taxpayer's petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Board redetermine the correct amount of the deficiency involved in this proceeding to be equal to the amount determined by the Commissioner, plus any additional amount which may arise from the correction of any error or errors that may have been committed by the Commissioner. Claim is hereby asserted for the increased deficiency, if any, resulting from such redetermination.

(Signed) C. M. CHAREST.
C. M. CHAREST.
General Counsel,
Bureau of Internal Revenue.

Of counsel:
C. C. HOLMES,
Special Attorney,
Bureau of Internal Revenue.

33 Before United States Board of Tax Appeals

[Title omitted.]

Stipulation (no. 58391)

Filed Nov. 14, 1932

Stipulation re: 1928 income tax

It is hereby stipulated by and between Susan Dwight Bliss, the above-named petitioner, by Donald Arthur, her agent, and the Commissioner of Internal Revenue, the above-named respondent by C. M. Charest, Esq., its general counsel, for the purposes of the trial and hearing of the above-entitled proceeding before the United States Board of Tax Appeals, as follows:

First. That ordinary net income as determined in letter from the Commissioner of Internal Revenue to Susan Dwight Bliss, dated

March 10, 1931, at $228,003.74, shall be reduced by the sum of $1,508.89 by allowing as a deduction the amount of fees paid to the Trustees of the George T. Bliss Agency Account upon income from tax-exempt securities.

Second. That capital net gain as determined in said letter of March 10, 1931, at $220,305.79, shall be reduced by the sum of $8,760.97.

34 Third. That said sum of $8,760.97 represents a capital loss upon the sale of 250 shares of Quincy Mining Company stock, which is properly deductible from capital gain and which is properly computed as follows:

Original cost of petitioner of 250 shares Quincy Mining Co. stock in December, 1916	$22,500.00
Less dividends received during 1917 to 1920, inclusive, determined to have been paid out of surplus accumulated prior to March 1, 1915, $14.776 per shares, on 250 shares	3,694.00
Adjusted basis	$18,806.00
Proceeds of sale by petitioner of said 250 shares Quincy Mining Co. stock in 1928	10,045.03
Loss, as adjusted	$8,760.97

Fourth. That the amount of charitable and other contributions made by petitioner during the year 1928 of a character deductible from net income, subject to the limitations provided in section 23 subdivision (n) of the Revenue Act of 1928, was $43,995.92. That the ordinary net income of petitioner before deduction of the amount of such contributions was $270,490.77. That the capital net gain was $211,544.82. That the total amount of said charitable and other contributions was deducted from gross income by petitioner in her return upon the claim that in determining the amount

35 of 15% of petitioner's net income for the year 1928 under section 23 subdivision (n) of the Federal Revenue Act of 1928, ordinary net income and capital net gain should both be included, which contention is asserted by petitioner and denied by the Commissioner, and this stipulation shall not prejudice the rights of either petitioner or respondent as to the legality of such deduction in excess of 15% of ordinary net income.

Dated, July 5, 1932.

DONALD ARTHUR,
Agent for Petitioner.

(Signed) C. M. CHAREST,
General Counsel of Commissioner of Internal Revenue.

Before United States Board of Tax Appeals

[Title omitted.]

Stipulation (no. 60709)

Filed November 14, 1932

Stipulation re: 1929 income tax

It is hereby stipulated by and between Susan Dwight Bliss,
36 the above-named petitioner, by Donald Arthur, her agent, and the Commissioner of Internal Revenue, the above-named respondent, by C. M. Charest, Esq., its general counsel, for the purposes of the trial and hearing of the above-entitled proceeding before the United States Board of Tax Appeals, as follows:

First. That net income as determined in letter from the Commissioner of Internal Revenue to Susan Dwight Bliss, dated October 31, 1931, shall be reduced by the sum of $6,922.03 in the following particulars

(a) By allowance as a deduction of the amount of fees paid to the trustees of the George T. Bliss agency account upon income from tax-exempt securities	$1,653.93
(b) By allowance as a deduction of amount of fees paid to others in agency account	268.10
(c) By allowance as a deduction of the sum of $5,000 representing a loss on stock of Stevenson & Cameron which cost petitioner $5,000 and became worthless in year 1929	5,000.00
	$6,922.03

Second. That the amount of charitable and other contributions made by petitioner during the year 1929, of the character deductible from net income, subject to the limitations provided in section 23, subdivision (n) of the Revenue Act of 1928, was $39,088.46.
37 That the ordinary net income of petitioner before the deduction of such contributions was $247,571.83. That the capital net gain was $299,942.31. That the total amount of said charitable and other contributions was deducted from gross income by petitioner in her return upon the claim that in determining the amount of 15% of petitioner's net income for the year 1929 under section 23, subdivision (n) of the Revenue Act of 1928, ordinary net income and capital net gain should both be included, which contention is asserted by petitioner and denied by the Commissioner, and that this stipulation shall not prejudice the rights of either petitioner or respondent as to the legality of such deduction in excess of 15% of ordinary net income.

Dated, July 5, 1932.

DONALD ARTHUR,
Agent for Petitioner.
(Signed) C. M. CHAREST,
General Counsel of Commissioner of Internal Revenue.

46334—34——2

38 Before United States Board of Tax Appeals

27 B.T.A.

SUSAN DWIGHT BLISS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Findings of fact and opinion

Docket Nos. 58391, 60709. Promulgated December 2, 1932

Deductions for charitable and other contributions allowed by section 23 (n) of the Revenue Act of 1928 are limited to an amount which does not exceed 15 per centum of the taxpayer's net income without such deductions, computed upon the basis of excluding all items of capital gain, capital loss, and capital deductions.

C. C. Holmes, Esq., for the respondent.

These are consolidated proceedings for the redetermination of deficiencies in income tax for the years 1928 and 1929 in the amounts of $1,909.31 and $1,009.41, respectively. The sole issue submitted for decision is whether or not the petitioner is entitled to deduct from gross income for each of the taxable years on account of charitable contributions an amount in excess of 15 percent of the ordinary net income computed without such deduction but less than 15 percent of the combined ordinary net income and capital net gain.

39 Findings of fact

The parties executed and filed at the hearing the following stipulations:

Taxable year 1928

First. That ordinary net income as determined in letter from the Commissioner of Internal Revenue to Susan Dwight Bliss, dated March 10, 1931, at $228,003.74, shall be reduced by the sum of $1,508.89 by allowing as a deduction the amount of fees paid to the trustees of the George T. Bliss agency account upon income from tax-exempt securities.

Second. That capital net gain as determined in said letter of March 10, 1931, at $220,305.79, shall be reduced by the sum of $8,760.97.

Third. That said sum of $8,760.97 represents a capital loss upon the sale of 250 shares of Quincy Mining Company stock, which is properly deductible from capital gain and which is properly computed as follows:

	Original cost of petitioner of 250 shares Quincy Mining Co. stock in December 1916	$22,500.00
	Less dividends received during 1917 to 1920, inclusive, determined to have been paid out of surplus accumulated prior to March 1, 1913, $14.776 per share, on 250 shares	3,694.00
	Adjusted basis	18,806.00
40	Proceeds of sale by petitioner of said 250 shares Quincy Mining Co. stock in 1928	10,045.03
	Loss, as adjusted	8,760.97

Fourth. That the amount of charitable and other contributions made by petitioner during the year 1928 of a character deductible from net income subject to the limitations provided in section 23 subdivision (n) of the Revenue Act of 1928, was $43,995.92. That the ordinary net income of petitioner before deduction of the amount of such contributions was $270,490.77. That the capital net gain was $211,544.82. That the total amount of said charitable and other contributions was deducted from gross income by petitioner in her return upon the claim that in determining the amount of 15 percent of petitioner's net income for the year 1928 under section 23, subdivision (n), of the Federal Revenue Act of 1928, ordinary net income and capital net gain should both be included, which contention is asserted by petitioner and denied by the Commissioner, and this stipulation shall not prejudice the rights of either petitioner or respondent as to the legality of such deduction in excess of 15% of ordinary net income.

Taxable year 1929

First. That net income as determined in letter from the Commissioner of Internal Revenue to Susan Dwight Bliss, dated October 31, 1931, shall be reduced by the sum of $6,922.03 in the following particulars:

41	(a) By allowance as a deduction of the amount of fees paid to the trustees of the George T. Bliss agency account upon income from tax exempt securities	$1,653.93
	(b) By allowance as a deduction of the amount of fees paid to others in agency account	268.10
	(c) By allowance as a deduction of the sum of $5,000 representing a loss on stock of Stevenson & Cameron which cost petitioner $5,000 and became worthless in the year 1929	5,000.00
		$6,922.03

Second. That the amount of charitable and other contributions made by petitioner during the year 1929 of the character deductible from net income, subject to the limitations provided in section 23, subdivision (n) of the Revenue Act of 1928, was $39,088.46. That the ordinary net income of petitioner before the deduction of such contributions was $247,571.83. That the capital net gain was $299,942.31. That the total amount of said charitable and other contri-

butions was deducted from gross income by petitioner in her return upon the claim that in determining the amount of 15% of petitioner's net income for the year 1929 under section 23, subdivision (n) of the Revenue Act of 1928, ordinary net income and capital net gain should both be included, which contention is asserted by petitioner and denied by the Commissioner, and that this stipulation shall not prejudice the rights of either petitioner or respondent as to the legality of such deduction in excess of 15% of ordinary net income.

42

Opinion

TRAMMELL: This case was submitted upon the pleadings and certain stipulations of the parties, set out above as our findings of fact. The issues presented in the original pleadings have been disposed of by said stipulations, but in an amended answer the respondent alleges that the deficiencies as originally determined by him were understated because of the allowance of deductions for contributions in excess of 15 percent of the petitioner's "ordinary net income" before deducting contributions, and asserts claim for increased deficiencies accordingly.

The petitioner claimed deductions from gross income for each of the taxable years in excess of 15 percent of her ordinary net income but in amounts less than 15 percent of her combined "ordinary net income" and "capital net gain." It is stipulated in effect that the amounts so claimed by the petitioner on account of contributions constitute allowable deductions within the purview, and subject to the limitations, of section 23 (n) of the Revenue Act of 1928, which provides that in computing "net income" there shall be allowed as deductions, among other things:

"(n) Charitable and other contributions.—In the case of an individual contributions or gifts made within the taxable year * * * to an amount which * * * does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. * * *"

43

Thus, the issue presented is whether the maximum amount which an individual may deduct for contributions in computing net income is 15 per cent of "ordinary net income", or whether such maximum deduction may include also a corresponding percentage of "capital net gain." This question involves a construction of the provisions of the statute relating to net income and capital net gains.

The Revenue Act of 1928 provides for the taxation of capital net gains as follows:

"Sec. 101. * * *

"(a) Tax in case of capital net gain. In the case of any taxpayer, other than a corporation who for any taxable year derives a capital net gain * * *, there shall, *at the election of the taxpayer*, be levied, collected, and paid, in lieu of all other taxes, imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the

manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain." [Emphasis supplied.]

It follows from the above provisions of the statute that if an individual taxpayer derives a capital net gain and elects to
44 have the tax computed at the special rate therein provided, as the petitioner in this case has done, the amount of such capital gain is excluded from gross income for the purpose of computing normal and surtaxes upon ordinary net income.

Section 21 of said act defines "net income" as meaning the gross income computed under section 22, less the deductions allowed by section 23, and the latter section provides in subsection (n) that in computing net income deductions for charitable contributions shall be allowed to an amount which does not exceed 15 percent of the taxpayer's net income computed without such deductions.

Hence, if the capital net gain has been excluded from gross income for the purpose of computing the tax thereon at the special rate provided, it cannot at the same time form a part of the basis for computing the maximum deduction allowable for contributions. On the other hand, if the taxpayer does not elect to have the capital gain taxed at the special rate, it is then included in the gross income, and the charitable deduction would be computed on the basis of the resulting net income.

This construction of the statute is further supported by the fact that section 101 (c) defines "ordinary net income" as meaning "the net income computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions." If capital gain is excluded from gross income and capital deductions are also excluded in computing "ordinary net income", it is obvious that the term "net income" as used in section 23, which furnishes the basis for computing the maximum
45 deduction for contributions, means "ordinary net income", and such deductions must be computed on the basis of net income from which all capital gain, capital loss and capital deductions have been excluded.

Again, section 101 (c) defines "capital net gain" as meaning "the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains."

Charitable contributions are not allowed as capital deductions, and cannot be used in computing maximum deductions for charitable contributions. The taxpayer cannot exclude capital gain from gross income for the purpose of getting the benefit of the lower rate of tax thereon, and at the same time include capital gain in gross income for the sole purpose of computing the maximum deduction for contributions.

In the above provisions of the statute, we think Congress has clearly and designedly limited allowable deductions for charitable

and other contributions to a maximum of 15 percent of the ordinary net income computed upon the basis of excluding all items of capital gain, capital loss and capital deductions.

The contention of the petitioner cannot be sustained. The deficiencies will be redetermined accordingly, after giving effect to the stipulations of the parties on other points, as set out in our findings of fact.

Judgment will be entered under Rule 50.

[Seal.]

46 Before United States Board of Tax Appeals, Washington

Docket Nos. 58391, 60709

SUSAN DWIGHT BLISS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

Pursuant to findings of fact and opinion promulgated December 2, 1932, the respondent herein, on December 29, 1932, having filed a proposed redetermination for the years 1928 and 1929, and the petitioner on January 18, 1933, having filed notice of acquiescence to the said proposed redetermination, it is

Ordered and decided, that there are deficiencies for the years 1928 and 1929 in the amounts of $1,196.87 and $15.54, respectively.

Enter:

Entered Jan. 31, 1933.

[SEAL.] (Signed) CHARLES M. TRAMMELL,
Member.

vlh

47 In United States Circuit Court of Appeals for the Second Circuit

U.S.B.T.A. Docket Nos. 58391, 60709

SUSAN DWIGHT BLISS, PETITIONER

against

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for review filed March 1, 1933

To the honorable judges of the Circuit Court of Appeals for the Second Circuit:

Comes now the petitioner, Susan Dwight Bliss, and respectfully shows:

I

The petitioner on review is an individual residing at No. 9 East 68th Street, Borough of Manhattan, New York City, within the jurisdiction of the United States Circuit Court of Appeals for the Second Circuit. The respondent on review is the Acting Commissioner of Internal Revenue of the United States duly appointed and holding his office by virtue of the laws of the United States.

This petition for review is filed pursuant to the provisions
48 of section 1001 of the Revenue Act of 1926, as amended by section 1101(a) of the Revenue Act of 1932, for the review of the decision of the United States Board of Tax Appeals rendered February 2, 1933, in accordance with an opinion promulgated December 2, 1932, whereby the court found that certain deductions on account of charitable contributions were improperly included by the petitioner in determining taxes due from her for the years 1928 and 1929.

II

Facts

These are consolidated proceedings for the redetermination of alleged deficiencies in income tax for the years 1928 and 1929. They were begun by notices of deficiency sent to petitioner by respondent in the amounts of $1,909.31 and $1,009.41, respectively, for the two years based on the refusal of respondent to allow certain deductions not material to this appeal claimed by petitioner in computing her income and capital net gain for the two years in question. By amended answer to petitioner's amended petition to the United States Board of Tax Appeals for redetermination of said alleged deficiencies respondent set forth additional grounds of deficiency upon which said Board of Tax Appeals rested its decision, namely, that petitioner had claimed and been allowed deductions for charitable contributions in excess of the 15% of petitioner's net income allowed as a deduction by section 23-(n) of the Revenue Act of 1928.

49 The parties executed and filed at the hearing before said Board various stipulations of fact, of which the following excerpts are involved in this appeal:

Taxable year 1928

Fourth. That the amount of charitable and other contributions made by petitioner during the year 1928 of a character deductible from net income subject to the limitations provided in section 23 subdivision (n) of the Revenue Act of 1928, was $43,995.92. That the ordinary net income of petitioner before deduction of the amount of such contributions was $270,490.77. That the capital net gain was $211,544.82. That the total amount of said charitable and other contributions was deducted from gross income by petitioner in her

return upon the claim that in determining the amount of 15 percent of petitioner's net income for the year 1928 under section 23 subdivision (n) of the Federal Revenue Act of 1928, ordinary net income and capital net gain should both be included, which contention is asserted by petitioner and denied by the Commissioner, and this stipulation shall not prejudice the rights of either petitioner or respondent as to the legality of such deduction in excess of 15% of ordinary net income.

Taxable year 1929

Second. That the amount of charitable and other contribu-
50 tions made by petitioner during the year 1929 of the character deductible from net income, subject to the limitations provided in section 23, subdivision (n) of the Revenue Act of 1928, was $39,088.46. That the ordinary net income of petitioner before the deduction of such contributions was $247,571.83. That the capital net gain was $299,942.31. That the total amount of said charitable and other contributions was deducted from gross income by petitioner in her return upon the claim that in determining the amount of 15% of petitioner's net income for the year 1929 under section 23, subdivision (n) of the Revenue Act of 1928, ordinary net income and capital net gain should both be included, which contention is asserted by petitioner and denied by the Commissioner, and that this stipulation shall not prejudice the rights of either petitioner or respondent as to the legality of such deduction in excess of 15% of ordinary net income.

III

The nature of the controversy is such as to give rise to but one issue:

1. Was petitioner entitled to deduct from gross income for each of the taxable years on account of charitable contributions amounts in excess of 15% of the ordinary net income computed without such deductions but less than 15% of the combined ordinary net income and capital net gain.

51 IV

Your petitioner desires to obtain a review of the afore-mentioned decision of the United States Board of Tax Appeals by this honorable court.

V

Your petitioner's assignment of error is:

1. The court erred as a matter of law in excluding capital net gain of petitioner in the years 1928 and 1929 from net income in such respective years in determining the 15% limitation in excess of which the charitable contributions of petitioner for such years should not be allowed as deductions and in refusing to allow as a de-

duction in such years from net income the full amount of such charitable contributions which were not in excess of 15% of ordinary net income and capital net gain for such years without such deduction.

Wherefore, your petitioner prays a review of the action of the United States Board of Tax Appeals in this case and that said decision of said Board be reversed.

(Sgd.) SUSAN DWIGHT BLISS,
Petitioner.
(% Gould & Wilkie, One Wall Street, New York City).

52 [*Duly sworn to by Susan Dwight Bliss, jurat omitted in printing.*]

53 In United States Circuit Court of Appeals, for the Second Circuit

[Title omitted.]

Notice of filing petition for review

Filed March 31, 1933

To the Commissioner of Internal Revenue, Washington, D.C.:

You are hereby notified that the above-named petitioner did on the 1st day of March 1933, file with the Clerk of the United States Board of Tax Appeals at Washington, D.C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 1st day of March 1933.

(Signed) GOULD & WILKIE.
Attorneys for Petitioner.
Office & Post Office Address,
One Wall Street, Borough of Manhattan, New York City.

54 Personal service of the above and foregoing notice together with a copy of the petition for review and assignments of error mentioned therein is hereby acknowledged this 1st day of March 1933.

(Signed) C. M. CHAREST.

In United States Circuit Court of Appeals, for the Second Circuit

[Title omitted.]

Praecipe for record

Filed March 31, 1933

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit, and deliver to the clerk of the United States Circuit Court of Appeals for the Second Circuit

copies, duly certified as correct, of the following documents and records in the above-entitled cause in connection with the
55 petition for review by the said Circuit Court of Appeals for the Second Circuit heretofore filed by the petitioner, Susan Dwight Bliss:

(1) Docket entries of the proceedings before the Board.

(2) Pleadings before the Board.

As to Docket No. 58391.

(a) The petition, including annexed copy of deficiency letter.

(b) Amended petition.

(c) Amended answer to amended petition.

As to Docket No. 60709.

(a) Petition, including annexed copy of deficiency letter.

(b) Amended answer to petition.

(3) Stipulations of fact filed by counsel.

(4) Findings of fact, opinion, and decision of Board.

(5) Petition for review and assignments of error together with proof of service of notice of filing petition for review and of service of copy of petition for review.

(6) Præcipe.

Dated, March 24, 1933.

(Signed) GOULD & WILKIE,
Attorneys for Petitioner,
Office & Post Office Address,
One Wall Street, Borough of Manhattan, New York City.

Service of a copy of the within præcipe is hereby admitted the 31st day of March 1933.

(Signed) C. M. CHAREST.

56 [Clerk's certificate to foregoing transcript omitted in printing.]

57 In United States Circuit Court of Appeals for the Second Circuit

No. ——

BLISS, SUSAN DWIGHT, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Motion for substitution

Comes now the above-named petitioner and moves the court that Guy T. Helvering, Commissioner of Internal Revenue, be substi-

tuted for David Burnet as respondent herein, and in support of said motion respectfully shows:

1. That the resignation of said David Burnet, who was Commissioner of Internal Revenue when the petition for review in this proceeding was filed, was duly accepted and he ceased to be such officer on May 15, 1933.

2. That Guy T. Helvering was duly appointed and confirmed as Commissioner of Internal Revenue to succeed the said David Burnet; that he qualified as such officer and entered upon the duties of said office on June 6, 1933, since which date the said Guy T. Helvering has been and now is Commissioner of Internal Revenue.

3. That there is a substantial need for continuing and maintaining this proceeding and obtaining an adjudication of the questions involved, for otherwise the order of the United States Board of Tax Appeals herein sought to be reviewed will become final and the right to have the legality thereof determined will be extinguished.

This motion is made pursuant to the provisions of sec. 11 of the act of February 13, 1925 (c. 229, 43 Stat. 941) (U.S.C., title 28, sec. 780).

GOULD & WILKIE,
Attorney for Petitioner.

DATED JUNE 7, 1933.

The undersigned, attorney for Guy T. Helvering, Commissioner of Internal Revenue, hereby expressly consents to the substitution sought by the above motion.

SEWALL KEY,
Special Assistant to the Attorney General,
Attorney for Guy T. Helvering,
Commissioner of Internal Revenue.

57a In United States Circuit Court of Appeals

Order of substitution

Upon motion of the petitioner, expressly consented to by Guy T. Helvering, Commissioner of Internal Revenue, it is hereby ordered that said Guy T. Helvering, as such officer, be and he hereby is substituted for David Burnet, former Commissioner of Internal Revenue, and that this proceeding be so continued and maintained.

WM. PARKIN, *Clerk.*

DATED JULY 15, 1933.

58 In United States Circuit Court of Appeals for the Second Circuit

No. 31—October Term, 1933

Argued December 20, 1933. Decided January 8, 1934

SUSAN DWIGHT BLISS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals.

Before L. HAND, SWAN, and AUGUSTUS N. HAND, Circuit Judges.

The taxpayer filed a petition for review of an order of the Board redetermining deficiencies in income taxes for the years 1928 and 1929 in the amounts of $1,196.87 and $15.54 respectively. Order reversed.

For the opinion below, see 27 B.T.A. 205.

Gould & Wilkie, of New York City (R. L. Von Bernuth and John F. Boyer, both of New York City, of counsel), for petitioner.

Sewall Key and J. P. Jackson, Sp. Assts. to Atty. Gen., for respondent.

Carlyle E. Yates, of New York City, amicus curiæ.

Opinion

SWAN, Circuit Judge.

But one question is presented, and that is common to both taxable years. It will suffice, therefore, to state the facts with reference to 1928 only. During that year the taxpayer made charitable contributions in the amount of $43,995.92, which she claims the right to deduct from gross income under section 23 (n) of the Revenue Act of 1928 (45 Stat. 801; 26 U.S.C.A., § 2023 (n)). This permits a deduction not exceeding "15 per centum of the taxpayer's net income as computed without the benefit of this subsection." Her "net income" for the year, as defined by section 21, and without any deduction for charitable contributions, was nearly half a million dollars and included an item of $211,544.82 "capital net gain", upon which she elected to be taxed at the 12½ percent rate under section 101 (a), 45 Stat. 811 (26 U.S.C.A., § 2101 (a)). If this item may properly be included in net income to compute the 15 percent allowance as a deduction for charitable contributions, the taxpayer was entitled to deduct the full amount of her charitable gifts and no deficiency exists; but if, as the Commissioner contends and as the Board held, it may not be so included, then her duduction was limited to $40,573.62 and the deficiency order was correct. Stated abstractly the question is whether, if a taxpayer elects to be taxed under section 101 (a) of the Revenue Act of 1928 (26 U.S.C.A.,

§ 2101 (a)), capital net gain may be included in his net income when computing the 15 percent deduction allowable for charitable contributions under section 23 (n).

This question has been decided in favor of the taxpayer in two District Court cases. Atkins v. White (3 F.Supp. 694 (D.Mass.)); Blow v. United States (D.C.N.D. Ill.; — F.Supp. —), decided September 1, 1933. It was decided adversely to the taxpayer by three different divisions of the Board of Tax Appeals, including the proceeding here sought to be reviewed. (Harbison v. Com'r (26 B.T.A. 896); Bliss v. Com'r (27 B.T.A. 205); Colgate v. Com'r (27 B.T.A. 506).) Compare, Elkins v. Com'r (24 B.T.A. 572); Livingood v. Com'r (25 B.T.A. 585). Subsequently, however, the question was reviewed by the entire Board, and its position was
59 completely reversed. (Straus v. Com'r (27 B.T.A. 1116.).

This opinion has been adhered to in Robinette v. Com'r (28 B.T.A. —), and Igleheart v. Com'r (28 B.T.A. —). From each of the foregoing decisions we are told that the losing party has taken an appeal, but none of the appeals has yet been decided.

The provision permitting a deduction from gross income of charitable contributions to the extent of 15 percent of the net income computed without the benefit of this deduction was introduced into the income tax law by section 1201 (2) of the Revenue Act of 1917 (40 Stat. 330). Its obvious purpose was to encourage gifts for charity, education, and science (Cong. Rec., September 7, 1917, p. 5728). It has been continued in substantially the same form in each successive revenue act. In the Revenue Act of 1921, § 206, the provision for taxing "capital net gain" at a rate different from that applied to income from other sources first appears (42 Stat. 232). The reasons for this enactment are concisely stated in Burnet v. Harmel (287 U.S. 103, 106; 53 S.Ct. 74; 77 L.E. 199). The provision appears in the 1928 act as section 101. Paragraph (a) thereof provides that an individual taxpayer who derives a "capital net gain", as defined in paragraph (c), may, at his election, have his tax determined as follows: "A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain." Paragraph (b) provides for determining the tax when an individual taxpayer sustains a "capital net loss"; a partial tax is computed as in paragraph (a) and from this amount 12½ per centum of the capital net loss is deducted to arrive at the total tax. Since the "partial tax" is first to be computed upon the basis of the "ordinary net income", we turn to section 101 (c) (7), 26 U.S.C.A., § 2101 (c) (7), for a definition of that phrase: "(7) 'Ordinary net income' means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductons." In the construction of this definition lies the controversy. The taxpayer contends that "net income, computed in accordance

with the provisions of this title", requires computation according to sections 21, 22, and 23 (26 U.S.C.A., §§ 2021–2023), and that from the computation thus made there are then "excluded", that is, stricken out or disregarded, all items of capital gain, capital loss, and capital deductions; that the figures remaining give "ordinary net income" and the figures excluded give "capital net gain." The commissioner, on the other hand, asserts that clause (7) should be read as though it directed net income to be computed "after excluding from the computation all items of capital gain, capital loss, and capital deductions.

It is to be noted that the phrase "ordinary net income" occurs in both paragraph (a), which deals with the case of capital net gain, and paragraph (b), which deals with the case of capital net loss. It must have the same meaning in each. A construction favorable to the taxpayer in the former will operate to his detriment in the latter, and vice versa. Hence the canon of strict construction invoked by the commissioner on the theory that the taxpayer is claiming the benefit of an exemption seems inapplicable. We can hardly say that there is any plain advantage to be gained by taxpayers from one construction rather than the other; it depends on whether in the long run cases of capital net gain involve larger sums than cases of capital net loss. Canons of interpretation aside, it seems to us that merely as a matter of verbal construction the meaning contended for by the petitioner is the more reasonable and the more compatible with the purpose of the statute. There is nothing in section 101 which expressly indicates that the taxpayer was intended to lose any part of the deductions allowed by section 23 when his tax is determined according to the rates provided in section 101. Paragraphs (a) and (b) deal with computation of the tax rather than with computation of taxable income; the usual rates are applied, "as if this section had not been enacted", to that part of the taxable income called "ordinary net income" and the special 12½ percent rate to "capital net gain" or "capital net loss." Paragraph (c) defines the terms used in the earlier paragraphs. It does not indicate an intention to modify the definitions of "net" and "gross" income contained in sections 21 and 22 (26 U.S.C.A., §§ 2021, 2022), nor to change the deductions allowed by section 23 (26 U.S.C.A., § 2023). On the contrary, clauses (3) and (4) of section 101 indicate that they are to remain unchanged. They divide such deductions into "capital deductions" and "ordinary deductions." The latter mean "the deductions allowed by section 23 other than capital losses and capital deductions." Clause (5) defining "capital net gain" makes it necessary to determine
60 whether "ordinary deductions" exceed "gross income computed without including capital gains." We do not understand this to be a direction that in computing "ordinary deductions" gross income is to be decreased by the exclusion of capital gains. It means to us that ordinary deductions are to be figured in the ordinary way and then compared with "gross income computed without including

capital gain" to see if they exceed it. If this be the correct construction, there is harmony between clause (5) and clause (7), and "net income" computed in accordance with sections 21, 22, and 23 is composed of two parts, "ordinary net income" and "capital net gain", to which respectively the appropriate rates may be applied as provided in paragraph (a).

This was the view of the Bureau of Internal Revenue for many years. On February 6, 1923, the Deputy Commissioner telegraphed in response to an inquiry: "Contributions; 15% limitation; Capital net gains: fifteen percent limitation for deductions account charitable contributions applies to total net income inclusive of gain from sale of capital assets" (C.C.H. Fed. Income Tax Service, 1924, par. 2033). In 1924 a corresponding ruling as to capital losses was made: "Capital losses cannot be excluded in computing net income for the purpose of determining the amount of charitable contribution deductions" (I.T. 404, Cum. Bul. III–2, p. 152). In 1928 the Government argued before this court that section 206 of the Revenue Act of 1921 (42 Stat. 232) (corresponding to section 101 of the 1928 act (26 U.S.C.A., § 2101)) related merely to rates and did not affect the computation of the allowance of charitable deductions, and we by dictum approved this construction (Sadowsky v. Anderson (C.C.A.) (29 F. (2d) 677, 679)). In November 1931 the Board of Tax Appeals decided Elkins v. Com'r (24 B.T.A. 572), and held, contrary to the ruling of the Bureau, that capital losses should be disregarded in computing the 15 percent deduction for charitable contributions. The Commissioner announced that this decision was "contrary to the position which the Bureau has consistently followed", and would be appealed (Int. Rev. Bul. XI–7, 5386; Mim. 3931). But when the decision in Harbison v. Com'r (26 B.T.A. 896) was announced in August 1932 the Commissioner withdrew his determination to appeal the Elkins case and acquiesced in the Harbison decision (Int. Rev. Bul. XI–49, 5896; Mim. 3986). The consistent administrative rulings of the Commissioner from 1923 to 1932, during which time the provisions in question were thrice reenacted, may properly be given weight by the courts (Brewster v. Gage (280 U.S. 327, 336; 50 S.Ct. 115; 74 L.Ed. 457)). We do not think that the Commissioner's subsequent about face renders the principle inapplicable. It is not a case where the administrative ruling was ambiguous, as in Burnet v. Chicago Portrait Co. (285 U.S. 1, 21; 52 S.Ct. 275; 76 L.Ed. 587).

In our opinion the taxpayer was entitled to the deduction claimed, and no deficiency in taxes existed.

The order is reversed.

L. HAND, Circuit Judge, dissents with opinion.

61 In United States Circuit Court of Appeals for the Second Circuit

No. 31. October term, 1933

Argued December 20, 1933. Decided January 8, 1934

SUSAN DWIGHT BLISS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals.
Before L. HAND, SWAN, and AUGUSTUS N. HAND, Circuit Judges.

Dissenting opinion

L. HAND, Circuit Judge (dissenting).

In spite of the contrary ruling for nine years in the Treasury and its very belated change of front, it appears to me that the intent is too plain for latitude of interpretation, though of course in view of the difference of opinion that has arisen I cannot feel as sure as I should, if the matter had come before me first. Section 23 (n) (2), 26 U.S.C.A., § 2023 (n) (2), puts a limit upon charitable gifts of "15 per centum of the taxpayer's net income as computed without the benefit of this subsection"; so that in first computing the net income all charitable gifts must be omitted. That gives a net income, but only tentatively; all charitable gifts may be then deducted until they reach the prescribed limit, which is 15 percent of the net income, already provisionally computed. Thus the final taxable income is computed in two steps. If that be so, it appears to me that section 101 (c) (7), 26 U.S.C.A., § 2101 (c) (7), becomes plain. The "ordinary net income" there defined is to be "computed in accordance with the provisions of this title", which as regards charitable gifts means that the limit must be fixed on a tentative net income. However, it is to be so computed only after excluding certain items; and "excluding" seems to me necessarily to relate to the first computation. It would be very unreal to suppose that it referred to the deduction of items not "excluded" but once included in the provisional computation; that after they had been included, and 15 percent of the result deducted, the same items should be reversed; the gains subtracted and the losses added. That is not "excluding" them from the computation; "excluding" means dealing with them once and for all. But if it is possible to suppose that they were to affect the computation at all, the more natural way was to use the definitions in (c), subd. (5) and subd. (6), 26 U.S.C.A., § 2101 (c) (5, 7), which had just been made; "capital net gain" would be subtracted from, or "capital net loss" added to, the net income. The definition would then have read: "'Ordinary net income' means net income computed in accordance with the provisions of this title after

deducting 'capital net gain' or adding 'capital net loss.'" I think that the Board was right.

62 In United States Circuit Court of Appeals, Second Circuit

SUSAN DWIGHT BLISS, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment filed Jan. 15, 1934

Appeal from the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is reversed.

It is further ordered that a mandate issue to the said Board in accordance with this decree.

WM. PARKIN, *Clerk.*

63 [File endorsement omitted.]

64 [Clerk's certificate to foregoing transcript omitted in printing.]

46334—34——3

U.S. GOVERNMENT PRINTING OFFICE: 1934

32 Supreme Court of the United States

Order allowing certiorari

Filed April 30, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, [redacted] 1934

No. 885 7

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

WILLIAM ALBERT HARBISON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 22, 1934
CERTIORARI GRANTED APRIL 30, 1934

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 888

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

WILLIAM ALBERT HARBISON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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1 Before United States Board of Tax Appeals

Docket No. 54347

WILLIAM ALBERT HARBISON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket entries

APPEARANCES:
For Taxpayer: J. E. MacCloskey, Jr., Esq.
For Comm'r.: J. Polk, Esq.

1931
Mar. 23—Petition received and filed. Taxpayer notified. (Fee paid.)
" 23—Copy of petition served on general counsel.
Apr. 6—Answer filed by general counsel.
" 10—Copy served—assigned General Calendar.

1932
Mar. 18—Hearing set April 26, 1932.
Apr. 22—Motion to amend answer embodying amendment filed by general counsel. April 23, 1932, copy served.
" 23—Motion to consolidate with docket 54346 filed by taxpayer.
" 26—Hearing had before Mr. Smith on merits. Petitioner moves to consolidate with docket 54346—granted. Submitted. Briefs due in 60 days. Stipulation of facts filed.
June 20—Transcript of hearing April 26, 1932, filed.
June 24—Brief filed by taxpayer.
2 June 25—Brief filed by general counsel.
July 13—Motion of April 22, 1932, granted.
Aug. 29—Findings of fact and opinion rendered, Mr. Smith, division 5. Judgment will be entered under rule 50.
Sept. 14—Petition for rehearing filed by general counsel. September 19, 1932, denied.
Nov. 2—Motion for rehearing filed by general counsel.
" 7—Order that motion for rehearing be denied entered.
Dec. 12—Order that order denying respondent's motion of November 7, 1932, be vacated; that motion of respondent be granted and proceeding be set for rehearing January 25, 1933, entered.
" 27—Motion that Board vacate its order of December 12, 1932, and reinstate order of November 7, 1932, filed by taxpayer.

1933

Jan. 4—Order that order of the Board entered December 12, 1932, be vacated and set aside; that motion of respondent of November 2, 1932, for rehearing be denied entered.

" 25—Hearing had before Mr. C. P. Smith on settlement under rule 50. Continued to March 1, 1933.

" 25—Order that petitioner and respondent file notices of settlement with the Board pursuant to findings of fact and opinion promulgated August 29, 1932, by March 1, 1933, at which time hearing will be had thereon entered.

3 Feb. 4—Notice of settlement filed by general counsel. February 7, 1933, copy served.

Mar. 1—Hearing had before J. E. Murdock, division 3, on settlement under rule 50. Referred to Mr. Smith for decision.

" 7—Decision entered, Charles P. Smith, division 5.

June 6—Petition for review by United States Circuit Court of Appeals (2) with assignments of error filed by taxpayer.

" 6—Proof of service filed by taxpayer.

July 21—Motion for extension of time of 60 days to complete record filed by taxpayer.

Order enlarging time to October 4, 1933, for preparation of evidence and delivery of record entered.

Sept. 1[illegible]—Agreed statement of evidence lodged.

" 13—Motion that statement of evidence be approved filed by taxpayer.

" 14—Agreed statement of evidence approved and ordered filed.

" 16—Praecipe filed.

" 27—Proof of service filed.

4 Before United States Board of Tax Appeals.

Docket No. 54347

WILLIAM ALBERT HARBISON, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition

Filed March 23, 1931

William Albert Harbison, petitioner above named, hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, Bureau symbols "IT:AR:A-2 FAJ-60D"; dated February 12, 1931, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual, whose full name is William Albert Harbison, with his residence, Sound View Avenue and Old Mamaroneck Road, White Plains, New York, and with his office at Graybar Building, 420 Lexington Avenue, New York City, New York, at which all tax matters are handled.

2. That notice of deficiency, a copy of which is hereto attached, made a part of this petition, and marked " Exhibit A ", was mailed to the petitioner on February 12, 1931.

3. The taxes in controversy are income taxes for the calendar year 1928; the deficiency claimed by the Commissioner of Internal Revenue for the year 1928 is $8,792.16.

4. The determination of the tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner of Internal Revenue erred in computing the gain on 1,000 shares of the common stock of Harbison-Walker Refractories Company sold by the petitioner during the year 1928, in that the Commissioner failed to base the computation on the difference between the selling price of the stock and the value of the same on May 11, 1925, which was the date of the termination of the trust created under the will of Samuel P. Harbison and was the time of the distribution of the said stock to the taxpayer.

(b) The Commissioner of Internal Revenue erred in computing the gain on the sale of the said 1,000 shares of the said Harbison-Walker Refractories Company common stock, in that the Commissioner based the gain on the difference between the selling price and the value of the said stock as of March 1, 1913.

5. The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(a) Samuel P. Harbison died May 11, 1905, leaving his last will and testament dated January 27, 1904, which was duly probated in the office of the register of wills, Allegheny County, Pennsylvania, on the 18th day of May 1905. A true and correct copy of the said will is hereto attached, made part of this petition, and marked " Exhibit B."

(b) The said Samuel P. Harbison owned a large number of shares of the common stock of the said Harbison-Walker Refractories Company and, in and by the said will, he devised practically all his property to his trustees, viz, Emma J. Harbison, Ralph W. Harbison, and your petitioner, William Albert Harbison, in trust to hold and manage the same for a period of twenty years from and after his death, and upon the termination of the trust, the will provided as follows:

" I give and bequeath to my said wife, Emma J. Harbison, one-third of my personal estate absolutely; to my son, William A. Harbison, one-third of my personal estate absolutely; to my son, Ralph W. Harbison, one-third of my personal estate absolutely."

(c) No inventory of the estate of Samuel P. Harbison was ever filed in court; no account was ever filed in court, and there never

was any decree of any court directing the distribution of said stock from the executors to the trustees.

(d) On May 11, 1925, the trust created under the said will terminated, and the said trust property including the said common stock of Harbison-Walker Refractories Company was distributed in accordance with the said will by the executors and trustees thereof, and your petitioner received one-third of the same, including
7 his share of the Harbison-Walker Refractories Company common stock hereinbefore referred to.

(e) On May 19, 1925, Harbison-Walker Refractories Company paid a stock dividend of 33⅓% to the holders of common stock.

(f) The market value of the common stock of Harbison-Walker Refractories Company on May 11, 1925, including the rights to the stock dividend, was $140.00 a share; giving allowance to the receipt of the stock dividend of 33⅓% on May 19, 1925, the market value on May 11, 1925, of the 1,000 shares of the common stock of the Harbison-Walker Refractories Company which were sold by your petitioner was $105.00 per share.

(g) The said 1,000 shares of common stock of the Harbison-Walker Refractories Company were sold by your petitioner during the year 1928 at the price of $150.00 per share.

Wherefore, the petitioner prays that this Board may hear the proceeding and that the said deficiency in the whole thereof assessed by the Commissioner be declared illegal and void.

J. E. MacCloskey, Jr.,
Counsel for Petitioner.
J. E. MacCloskey, Jr.,
1712 Farmers Bank Building, Pittsburgh, Pa.

8 [*Duly sworn to by William Albert Harbison, jurat omitted in printing.*]

9 *Exhibit A to petition*

[Copy]

NP–2–28

Treasury Department,
Office of Commissioner of Internal Revenue,
Washington, Feb. 12, 1931.

Address reply to Commissioner of Internal Revenue and refer to

Mr. William Albert Harbison,
Graybar Building, 420 Lexington Avenue,
New York, New York.

Sir: You are advised that the determination of your tax liability for the year(s) 1928 discloses a deficiency of $8,792.16, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing

of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D.C., for the
10 attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,
Commissioner.
By (Signed) J. C. WILMER,
Deputy Commissioner.

Enclosures:
Statement.
Form 882.
Form 870.

STATEMENT

IT:AR:A-2.
FAJ-60D.

In re: Mr. William Albert Harbison, Graybar Building, 420 Lexington Avenue, New York, New York

Tax liability

Year	Tax liability	Tax assessed	Deficiency
1928	$17,384.24	$8,592.08	$8,792.16

Reference is made to the report of the internal-revenue agent in charge, 250 West 57th Street, New York, New York, covering an investigation of your tax liability for the year 1928, also your
11 protest thereto received by the agent October 21, 1930, and the records of a conference held in the agent's office November 25, 1930.

On the basis of the agent's report and information at hand in this office your income and tax liability have been adjusted as follows:

Net income including capital gain as shown on return	$94,901.13
Add: 1. Capital gain increased	80,750.00
Total	175,651.13
Less: 2. Contributions increased	11,249.57
Net income adjusted	164,401.56
Less: Capital gain adjusted ($45,013.52 plus $80,750.00)	125,763.52
Income subject to surtax	38,638.04

Less:		
Dividends	$114,782.50	
Credit for dependent	400.00	
		$115,182.50
Balance subject to normal tax		None
Surtax on $38,638.04		1,663.80
Tax at 12½% on $125,763.52		15,720.44
Total tax assessable		17,384.24
Tax previously assessed		8,592.08
Deficiency		8,792.16

12 Explanation of changes

1. The profit on the sale of 1,000 shares of Harbison Walker Refractories Company common stock has been adjusted as follows:

Selling price, 1,000 shares		$150,870.00
March 1, 1913, value $48.50 per share stock dividends reduce the above March 1, 1913, value to $24.25 per share.		
1,000 shares at $24.25	$24,250.00	
Commissions	856.48	
		25,106.48
Capital gain corrected		125,763.52
Capital gain reported		45,013.52
Capital gain increased		80,750.00

The above adjustment is in conformity with general counsel memorandum 6195, Cumulative Bulletin VIII–1, page 99. The stock in question was part of the residuary estate of Samuel P. Harbison, which under the will was set aside in trust for a period of twenty years. The trust could be terminated at any time prior to the twenty years by majority decisions of the trustees who were the beneficiaries of the residuary estate. The above trust terminated May 11, 1925, and the stock in question was received by the beneficiaries. In determining the gain or loss from the sale, you used as a basis the value as at May 11, 1925. This is not in conformity with general counsel memorandum 6195 and it is held that the value at the time of
13 distribution to the trust by the executors governs and this being prior to March 1, 1913, the March 1, 1913, value governs in the instant case.

2. Contributions as reported were limited to fifteen percent of the net income. They are now adjusted to conform to the above increase in income, and is the full amount as shown on schedule attached to the return.

Due to the fact that the statute of limitations will presently bar any assessment of additional tax against you for the year 1928, the Bureau will be unable to afford you an opportunity under the provisions of article 451 of Regulations 74 to discuss your case before mailing formal notice of its determination as provided by section 272 (a) of the Revenue Act of 1928. It is, therefore, necessary at this time to issue this formal notice of deficiency.

Exhibit B to petition

[Copy]

LAST WILL AND TESTAMENT

I, SAMUEL P. HARBISON, of the city of Allegheny, in the county of Allegheny and State of Pennsylvania, do hereby make this my last will and testament, revoking all other wills by me at any time heretofore made.

First. I direct that all of my just debts shall be fully paid as soon as conveniently may be done after my decease, including my charity obligations for the current year, as shown by the charity
14 account in my personal account book, and what remains of the charity fund, as shown by said account, if any there be, I give and bequeath to my wife, Emma, to dispose of as she may deem best for charitable purposes. If my outstanding charitable obligations are in excess of the balance standing to the credit of the said charity account, the difference between the amount of the said obligations and the said balance shall be paid by my executors out of my personal estate.

Second. I give and bequeath to my wife, Emma, all my household furniture, useful and ornamental, horses, carriages, livestock, harness, and other stable furniture, absolutely, and the use of the homestead, embracing about ten acres of land on the western end of the Davis Avenue property, free of rent for her life, or so long as she desires to occupy the same as a home.

Third. All the rest, residue, and remainder of my estate, real, personal, or mixed, I give, devise, and bequeath to my executors hereinafter named, their heirs, successors and assigns, for the following uses and trusts, viz:

To hold and manage the same as a whole, and to invest and reinvest the same from time to time in such securities as in their judgment shall be deemed advisable, with full power in my said executors and trustees to sell any real estate, either at public or private sale, for such sums or prices as they may deem proper, and to execute, acknowledge, and deliver good and sufficient deeds, leases, and other assurances therefor without leave of court, and without any obligation upon the part of the purchaser to see to the
15 application of the purchase money; and upon the further trust, after deducting all taxes, charges or expenses whatsoever incident to the execution of this trust, pay over the net income, rents, issues, and profits thereof to my wife, Emma J. Harbison, and my two sons, William A. Harbison and Ralph W. Harbison, equally, that is to say, share and share alike, during the continuance of this trust.

The above trust shall continue for a period of twenty years from and after my decease unless sooner terminated as hereinafter provided, and upon the termination of this trust, I give and bequeath my said estate as follows:

I give and bequeath to my said wife, Emma J. Harbison, one-third of my personal estate absolutely; to my son, William A. Harbison, one-third of my personal estate absolutely; to my son, Ralph W. Harbison, one-third of my personal estate absolutely.

I give and bequeath all my real estate to my two sons, William A. Harbison and Ralph W. Harbison, their heirs and assigns, share and share alike, but subject to the following charge, to-wit: That they shall pay to my said wife, Emma J. Harbison, one-third of the net income derived from the said real estate during her natural life, and in the event of the sale of all or any part of the said real estate, one-third of the net income derived from the proceeds thereof during her natural life.

Should any one of the said devisees die during the continuance of this trust, then, in that event, as to the share of the one so dying, the trust shall terminate, and the said share shall be dis-
16 tributed to such person or persons as would be entitled to receive the same under the intestate laws of Pennsylvania had such devisee died seized of the same in his or her own right.

I further direct that if at any time during the continuance of this trust my said executors, or a majority of them, shall deem at best to terminate the said trust, the said trust may be terminated by a declaration in writing to that effect, and thereupon the said trust shall cease and determine, and the said estate shall be divided and distributed among my said wife, Emma J. Harbison, and my two sons, William A. Harbison and Ralph W. Harbison in the proportions above designated.

I have no provision in my will for any charitable bequests as I have during my life administered largely upon my own estate, and have, from year to year, given to the Lord's work, and other charities, as though it were my last. This course I expect to pursue so long as I may live. In leaving my estate to my family it is my hope that they may act upon the same principle, remembering that "the King's business requires haste", and that what we do for Him ought to be done quickly, so that should He come in my time or in your time we be not found with His money in our hands that ought to have been out doing service in His cause.

Fourth. I appoint my wife, Emma J. Harbison, executrix and trustee, and my two sons, William A. Harbison and Ralph W. Harbison, executors and trustees of this my last will and testament, and I direct that they shall file no inventory or account, and shall have absolute discretion in the settlement of my estate.

17 In witness whereof, I have hereunto set my hand and seal, this twenty seventh day of June, in the year of our Lord one thousand nine hundred and four.

SAMUEL P. HARBISON. [SEAL]

Signed, sealed, published and declared by the said Samuel P. Harbison as and for his last will and testament, in the presence of us, and of each other, who, at his request, and in his presence, and

in the presence of each other, have hereunto set our nomes as witnesses in due attestation thereof.

WILLIAM WALKER.
O. M. REIF.

Before United States Board of Tax Appeals

(Title omitted.)

Answer

Filed April 6, 1931

The Commissioner of Internal Revenue, by his attorney C.
18 M. Charest, general counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

1, 2, and 3. Admits the allegations contained in paragraphs 1, 2, and 3.

4. Denies the respondent's notice of deficiency is based upon the errors alleged and set forth in paragraph 4.

5(a). Admits the allegation contained in paragraph 5(a).

5(b). Admits the allegations contained in paragraph 5(b).

5(c). For lack of information denies the allegations contained in paragraph 5(c).

5(d). Denies the allegations contained in paragraph 5(d).

5(e). Admits the allegations contained in paragraph 5(e).

5(f). Denies the allegations contained in paragraph 5(f).

5(g). Admits the allegations contained in paragraph 5(g).

Wherefore, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of counsel:
W. FRANK GIBBS,
Special Attorney, Bureau of Internal Revenue.

19 Before United States Board of Tax Appeals

Docket Nos. 54346, 54347

RALPH W. HARBISON, WILLIAM ALBERT HARBISON, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Motion to consolidate

Filed April 23, 1932

Come now both parties in the above-entitled proceedings, by their respective attorneys of record, and move that the Board consolidate

the above-entitled cases for hearing and decision and for reason state that the two appeals involve identical issues and can be disposed of on the basis of the same evidence.

(Signed) J. E. MacCloskey, Jr.,
Attorney for Petitioners.
(Signed) C. M. Charest,
General Counsel, Bureau of Internal Revenue.

Motion granted at hearing April 26, 1932.

20 Before United States Board of Tax Appeals

[Title omitted.]

Motion for leave to amend answer

Filed April 22, 1932

Comes now the Commissioner of Internal Revenue, by his attorney, C. M. Charest, general counsel, Bureau of Internal Revenue, and moves the Board for leave to amend the answer in the above-entitled case heretofore filed to add the further paragraphs 5 (h) and 5 (i) and the prayer for an increased deficiency as follows:

5 (h). Alleges that the petitioner, William Albert Harbison had during the taxable year 1928 an "ordinary net income" of $66,634.87 as defined by section 101 (c) of the Revenue Act of 1928 but without any allowance of a deduction for contributions as provided by section 23 (n) of the Revenue Act of 1928; that the total amount of contributions made during the taxable year 1928 by the petitioner to organizations within the provisions of section 23 (n) of the Revenue Act of 1928 was $27,996.83; that William Albert Harbison elected to have the gain or loss on the sale of the common stock of Har-

21 bison-Walker Refractories Company taxed under the capital net gain and loss provisions of section 101 of the Revenue Act of 1928; that a deduction for contributions in the amount of $16,747.26 was claimed in computing the income on the original return and that in the deficiency letter the full amount of the total contributions made of $27,996.83 was allowed as a deduction.

5 (i). Respondent alleges that he erred in the computation of the amount of contributions allowable as a deduction in that he applied the 15% limitation to the total income, including capital gain, whereas the amount of the deductible contributions is by the provisions of the revenue act limited to 15% of the ordinary net income of the petitioner or to the sum of $9,996.23 and by reason of this error the income shown in the deficiency letter was understated in the amount of $18,001.60.

Wherefore, it is prayed that the Board redetermine the amount of the deficiency involved in this proceeding to be equal to the amount determined by the Commissioner, plus the additional amount which arises from the correction of the error in the allowance of the

excessive deduction for contributions in the deficiency letter. Claim is hereby asserted by the increased deficiency resulting from such redetermination.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of Counsel:
JAMES K. POLK, Jr.,
Special Attorney, Bureau of Internal Revenue.

22 Before United States Board of Tax Appeals
[Title omitted.]

Stipulation as to facts

Filed Apr. 26, 1932

It is hereby stipulated and agreed by and between the parties hereto, through their respective attorneys of record, that the following shall be considered to be the facts in these proceedings:

1. The petitioners, Ralph W. Harbison and William Albert Harbison were trustees and beneficiaries under a trust created by the will of their father, Samuel P. Harbison. The said Samuel P. Harbison died testate May 11, 1905, a true copy of his will being attached to the petition filed with the Board of Tax Appeals in each of the proceedings assigned docket numbers 54346 and 54347.

2. The trust created by paragraphs third and fourth of the will of Samuel P. Harbison was in existence and operation until May 11, 1925, at which time it terminated.

23 3. No inventory of the estate of Samuel P. Harbison was ever filed in court, no account was ever filed in court, and there never was any decree of any court directing the distribution of said stock from the executors to the trustees.

4. Including in the corpus of the trust created by the will of Samuel P. Harbison there were 24,692 shares of the common stock of the Harbison-Walker Refractories Company, this stock having a fair market value per share on March 1, 1913, of $48.50 and a fair market value on May 11, 1925, per share of $140.00. During 1920 there was received on the common stock of the Harbison-Walker Refractories Company held by the trust created by the will of Samuel P. Harbison a stock dividend of 50% and on May 19, 1925, an additional stock of the Harbison-Walker Refractories Company of 33⅓%. The fair market value of the shares of stock on May 19, 1925, after the issuance of the stock dividend, was $105 a share.

5. On May 12, 1925, one third of the stock formerly registered in the name of the estate of Samuel P. Harbison was trasferred on the books of the company to the name of Ralph W. Harbison and one third thereof to the name of William Albert Harbison and new stock certificates were delivered by the corporation to Ralph W.

Harbison and William Albert Harbison. During 1928, out of the shares of the stock of the Harbison-Walker Refractories Company so held by William Albert Harbison and Ralph W. Harbison,
24 certain shares were sold, namely, William Albert Harbison sold 1,000 shares receiving therefor a cash consideration of $150,870 and Ralph W. Harbison sold 998 shares and received a cash consideration therefor of $149,700.

6. William Albert Harbison had during the taxable year 1928 an "ordinary net income" of $66,634.87 as defined by section 101 (c) of the Revenue Act of 1928, but without any allowance of a deduction for contributions as provided by section 23 (n) of the Revenue Act of 1928. The total amount of contributions made during the taxable year 1928 by William Albert Harbison to organizations within the provisions of section 23 (n) of the Revenue Act of 1928 was $27,996.83. William Albert Harbison elected to have the gain or loss on the sale of the common stock of the Harbison-Walker Refractories Company taxed under the capital net gain and loss provision, section 101, of the Revenue Act of 1928. A deduction was claimed on the original return for contributions in the amount of $16,747.26, and the deduction for contributions was allowed by the Commissioner in the deficiency letter in the amount of $27,996.83.

These proceedings may be submitted upon the pleadings and this stipulation of facts without the introduction of further evidence, and each party allowed sixty days from the date of the Board's order pursuant hereto within which to file briefs.

(Signed) J. E. MacCloskey, Jr.,
Attorney for petitioners.
(Signed) by C. M. Charest,
General Counsel, Bureau of Internal Revenue.

25 Before United States Board of Tax Appeals

Docket Nos. 54346, 54347

Ralph W. Harbison, petitioner

v.

Commissioner of Internal Revenue, respondent

William Albert Harbison, petitioner

v.

Commissioner of Internal Revenue, respondent

Promulgated August 29, 1932

Findings of fact and opinion

Under section 113 (a) (5) of the Revenue Act of 1928, the basis for determining gain or loss upon the sale of personal property ac-

quired by will, upon the termination of a trust, is the fair market value of the property at the time of the distribution to the taxpayer in 1925.

In determining the 15 percent deduction for contributions within the purview of section 23 (n) of the Revenue Act of 1928, the taxpayer having realized a capital net gain during that year and having elected to have that gain taxed at the rate provided in section
26 101 (a) of the Revenue Act of 1928, the amount of the capital net gain should be excluded from the amount of the taxpayer's ordinary net income.

J. E. MacCloskey, Jr., Esq., for the petitioners.

James K. Polk, Esq., for the respondent.

These proceedings duly consolidated are for the redetermination of deficiencies in the petitioners' income tax for 1928 as follows:

Docket No.	*Deficiency*
54346	$11,976.34
54347	8,792.16

The petitioners allege that the Commissioner erred in computing the gain upon the sale of certain shares of stock upon the basis of its March 1, 1913, value instead of its value on May 11, 1925, when distributed to them. In Docket No. 54347 the Commissioner duly asserted claim for an increased deficiency, alleging that he had erroneously computed the 15 percent allowance for charitable contributions. The facts were stipulated.

FINDINGS OF FACT

The petitioners were trustees and beneficiaries of a trust created by the will of their father, Samuel P. Harbison, who died May 11, 1905. Insofar as material to our determination the decedent's will provided:

Third. All the rest, residue, and remainder of my estate,
27 real, personal or mixed, I give, devise and bequeath to my executors hereinafter named, their heirs, successors and assigns, for the following uses and trusts, viz:

"To hold and manage the same as a whole, and to invest and reinvest the same from time to time in such securities as in their judgment shall be deemed advisable, with full power in my said executors and trustees to sell any real estate, either at public or private sale, for such sums or prices as they may deem proper, and to execute, acknowledge, and deliver good and sufficient deeds, leases, and other assurances therefor without leave of court, and without any obligations upon the part of the purchaser to see to the application of the purchase money; and upon the further trust, after deducting all taxes, charges, or expenses whatsoever incident to the execution of this trust, pay over the net income, rents, issues, and profits thereof to my wife, Emma J. Harbison, and my two sons, William A. Harbison and Ralph W. Harbison, equally, that is to say, share and share alike, during the continuance of this trust.

"The above trust shall continue for a period of twenty years from and after my decease unless sooner terminated as hereinafter provided, and upon the termination of this trust, I give and bequeath my said estate as follows:

"I give and bequeath to my said wife, Emma J. Harbison, one-third of my personal estate absolutely; to my son, William A.
28 Harbison, one-third of my personal estate absolutely; to my son, Ralph W. Harbison, one-third of my personal estate absolutely.

"I further direct that if at any time during the continuance of this trust my said executors, or a majority of them, shall deem it best to terminate the said trust, the said trust may be terminated by a declaration in writing to that effect, and thereupon the said trust shall cease and determine, and the said estate shall be divided and distributed among my said wife, Emma J. Harbison, and my two sons, William A. Harbison and Ralph W. Harbison in the proportions above designated.

"Fourth. I appoint my wife, Emma J. Harbison, executrix and trustee, and my two sons, William A. Harbison and Ralph W. Harbison, executors and trustees of this my last will and testament, and I direct that they shall file no inventory or account, and shall have absolute discretion in the settlement of my estate."

The trust created by the decedent's will continued until May 11, 1925, when it terminated and the proptrty therein was distributed.

No inventory or account of the decedent's estate was ever filed in court, and there has been no court decree directing the distribution of the stock involved in these proceedings from the executors to the trustees.

Included in the corpus of the trust created by the will of the decedent were 24,692 shares of the common stock of the Harbison-Walker Refractories Co., which had a fair market value
29 of $48.50 per share on March 1, 1913, and a fair market value of $140 per share on May 11, 1925. A stock dividend of 50 percent was received upon this stock in 1920, and an additional stock dividend of 33⅓ percent was issued on May 19, 1925. After the issuance of the stock dividend on May 19, 1925, this stock had a fair market value of $105 per share.

On May 12, 1925, one-third of the stock thertofore registered in the name of the estate of Samuel P. Harbison was transferred on the books of the corporation to each petitioner and new stock certificates delivered to them. In 1928, petitioner William Albert Harbison sold 1,000 shares of this stock for a cash consideration of $150,870, and petitioner Ralph W. Harbison sold 998 shares of this stock for a cash consideration of $149,700.

The Commissioner reduced the March 1, 1913, fair market value of $48.50 per share to $28.25 per share on account of the stock dividends, and computed the gain upon the sales in 1928 upon that basis.

William Albert Harbison had during the taxable year 1928 an "ordinary net income" of $66,634.87 as defined by section 101 (c) of

the Revenue Act of 1928 but without any allowance of a deduction for contributions as provided by section 23 (n) of the Revenue Act of 1928. The total amount of contributions made during the taxable year 1928 by William Albert Harbison to organizations within the provisions of section 23 (n) of the Revenue Act of 1928 was $27,996.83. William Albert Harbison elected to have the gain or loss on the sale of the common stock of the Harbison-Walker
30 Refractories Co., taxed under the capital net gain and loss provision, section 101, of the Revenue Act of 1928. A deduction was claimed on the original return for contributions in the amount of $16,747.26, and the deduction for contributions was allowed by the Commissioner in the deficiency letter in the amount of $27,996.83.

OPINION

SMITH: The first issue, common to both dockets, is the proper basis for computing the gain upon the sale of certain stock in the taxable year. This stock was distributed to the petitioners on May 11, 1925, after the termination of the trust created under the will of the petitioners' father, who died May 11, 1905. The respondent contends that the basis is the March 1, 1913, value of the stock, whereas the petitioners contend that its value when distributed to them in 1925 is the proper basis. The basis for determining gain or loss from the sale or other disposition of property is prescribed by section 113 of the Revenue Act of 1928, which, insofar as material to our determination, is as follows:

"(a) (5) Property transmitted at death. If personal property was acquired by specific bequest, or if real property was acquired by general or specific device or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall
31 be the fair market value of the property at the time of the death of the decedent. *In all other cases if the property was acquired either by will or intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer.*" * * * [Italics supplied.]

In comparable cases arising under prior revenue acts the basis for computing gain or loss was the value of property when "acquired" or at the "time of acquisition", which terms have been interpreted to mean the value at the date of the decedent's death. See Brewster v. Gage, 280 U.S. 327, 50 Sup.Ct. 115, 117. In noting the change in the wording of sectoon 113 (a) (5) of the Revenue Act of 1928, the Supreme Court said:

"The Revenue Act of 1928, § 113 (a) (5) expressly established value at the time of the death of the decedent as the basis of calculation in respect of sales of personal property acquired by specific bequest and of real estate acquired by general or specific devise or

by intestacy, and in all other cases fixed fair market value at the time of distribution to the taxpayer as the basis. 45 Stat. 819 (26 U.S.C.A., § 2113). The deliberate selection of language so differing from that used in the earlier acts indicates that a change of law was intended. Ordinarily, statutes establish rules for the future, and they will not be applied retrospectively unless that purpose plainly appears. United States *v.* Magnolia Co., 276 U.S. 160, 162,
32 48 S.Ct. 236, 72 L.Ed. 509, and cases cited. There is no support for the suggestion that subdivision (5) expressed the meaning, or was intended to govern or affect the construction, of the earlier statutes."

The original change in the Revenue Act of 1928 was recommended to Congress by the Joint Committee on Internal Revenue Taxation in order "to make the basis certain and definite" and avoid the doubt as to what is meant by the date of acquisition. See report of joint committee—vol. 1, pp. 17, 74, 75. The Ways and Means Committee Report No. 2, page 18, 70th Congress, first session, indicates that it accepted the joint committee's recommendation and states that "the value on the date of death affords an equitable and more readily determinable basis."

The Senate Finance Committee Report No. 960, page 28, 70th Congress, first session, contains the following explanation respecting section 113 (a) (5), which was enacted as changed by the Senate:

"The decision by the Court of Claims in McKinney *v.* United States has caused confusion in the existing law as to the basis on which an executor must determine gain or loss on the sale by him of property of the estate. The House bill in section 113 (a) (5) provides that in such cases the basis shall be the fair market value of the property at the time of the death of the decedent. In the same section the House bill provides the same basis shall be used where the property is sold by the beneficiary.

33 "It appears that the House bill is inadequate to take care of a number of situations which frequently arise. For example, the executor, pursuant to the terms of the will, may purchase property and distribute it to the beneficiaries, in which case it is impossible to use the value at the decedent's death as the basis for determining subsequent gain or loss, for the decedent never owned the property. Moreover, the fair market value of the property at the decedent's death can not properly be used as the basis, in the case of property transferred in contemplation of death where the donee sells the property while the donor is living.

"Accordingly, the committee has revised section 113 (a) (5) and certain related sections, so as to provide that in the case of a specific bequest of personalty or a general or specific devise of realty, or the transmission of realty by intestacy, the basis shall be the fair market value at the time of the death of the decedent. In these cases it may be said, as a matter of substance, that the property for all practical purposes vests in the beneficiary immediately upon the decedent's

death, and therefore the value at the date of death is a proper basis for the determination of gain or loss to the beneficiary. The same rule is applied to real and personal property transmitted by the decedent, where the sale is made by the executor. In all other cases the basis is the fair market value of the property at the time of the distribution to the taxpayer. The latter rule would obtain,
34 for example, in the case of personal property not transmitted to the beneficiary by specific bequest, but by general bequest or by intestacy. It would also apply in cases where the executor purchases property and distributes it to the beneficiary."

The legislative history of this provision indicates that Congress intended to apply the provision—

"* * * In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of distribution to the taxpayer * * *"

to personal property not acquired by specific bequest but either under the will of the decedent or by reason of intestacy when sold by a taxpayer.

The petitioners acquired the stock in question under the terms of their father's will, after the termination of the trust. There was no specific bequest of this stock, which was a portion of the decedent's personal property. The basis with which we are concerned is not "the basis in the hands of the estate" but the basis to these taxpayers, which is the fair market value of the stock at the time of distribution to them on May 11, 1925. This value, properly adjusted to reflect the subsequent stock dividends, is stipulated to be $105 per share. The petitioners' gain upon the sale of the shares of stock in 1928 should be compared accordingly. Cf. Lane *v.* Corwin, Fed. — (2d) —, decided D.C., E.D., N.Y., July 5, 1932.

35 The petitioner in Docket No. 54347 elected to have his capital net gain upon the sale of the above stock taxed at the 12½ per cent rate provided in section 101 (a) of the Revenue Act of 1928. During the taxable year he made contributions in the amount of $27,996.83 to organizations within the purview of section 23 (n) of the Revenue Act of 1928. The second issue concerns only that petitioner and the computation of the allowable deduction for these contributions which is limited to "15 per centum of the taxpayer's net income as computed without the benefit of this subsection" (see section 23 [n]). By an amended answer the respondent alleges that he erroneously allowed the deduction of the total amount of these contributions, whereas the allowance should have been limited to 15 per cent. of this petitioner's net income, other than capital gains. The respondent duly asserts claim for the increased deficiency that may result from the recomputation of this deduction.

This petitioner, having elected to have his profit upon the stock sold taxed under the provisions of section 101 (a) of the Revenue Act of 1928, is subject to the tax imposed by that provision, which is determined as follows:

"* * * a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain."

"Ordinary net income", as used in connection with this pro-
36 vision "means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions." (See section 101 [c] [7].) In other words, when a taxpayer avails himself of the benefits of section 101 (a), he elects, in effect, to have his tax liability determined in two parts; first, upon the ordinary net income exclusive of his capital net gain, and, second, upon his capital net gain at the 12½ per cent. rate; the sum of the two constitutes the amount of his tax. Obviously, therefore, the amount of this petitioner's capital net gain should be excluded from the amount of his net income upon which to compute the 15 per cent. for deduction for contributions within the purview of section 23 (n). This last amount, stipulated as $66,634.87, is petitioner's "ordinary net income" as prescribed by sections 101 (a) and 21, computed without the benefit of subsection 23 (n), upon which to compute the 15 per cent. deduction. Cf. Hallie D. Elkins, 24 B.T.A. 572.

Judgment will be entered under rule 50.

37 Before United States Board of Tax Appeals

Docket No. 54347

WILLIAM ALBERT HARBISON, PETITIONER

v.

COMMISSIONER OF INTERNATIONAL REVENUE, RESPONDENT

Decision

Pursuant to the findings of fact and opinion of the Board in the above-entitled proceeding promulgated August 29, 1932, the respondent, on February 4, 1933, filed a notice of settlement with statement of recomputation attached. Hearing was had thereon on March 1, 1933, at which time the recomputation filed by the respondent was not contested. Wherefore, it is

Ordered and decided that there is a deficiency in tax for the year 1928 due from the petitioner in the amount of $930.56.

[SEAL] (Signed) CHARLES E. SMITH,
Member.

Entered Mar. 7, 1933.
Enter:
CPS: aa.

38 Before United States Board of Tax Appeals

[Title omitted.]

Petition for Review

Filed June 6, 1933

The taxpayer, William Albert Harbison, the petitioner in this cause, by J. E. MacCloskey, Jr., his counsel, hereby files his petition for a review by the Court of Appeals of the Second Circuit of the decision by the United States Board of Tax Appeals rendered on March 7th, 1933, determining a deficiency in the petitioner's Federal income taxes for the year 1928, in the amount of $930.56, and respectfully sets forth as follows:

I

The petitioner, William Albert Harbison, has his residence at Sound View Avenue and Old Mamaroneck Road, White Plains, New York, and is an inhabitant of White Plains, New York.

II

The controversy involves the proper determination of the taxpayer's liability for Federal income taxes for the calendar year 1928.

39 The Commissioner of Internal Revenue claimed a deficiency in the case of your petitioner on account of the profit arising from the sale of certain Harbison-Walker Refractories Company common stock; the Commissioner also claimed a deficiency for the same year in the income taxes of Ralph W. Harbison for the same reason. The said Ralph W. Harbison and your petitioner filed separate petitions to the Board of Tax Appeals for a redetermination of the deficiency set forth by the Commissioner in his notices of deficiency, the petition of the said Ralph W. Harbison being numbered 54346, and of the said William Albert Harbison, 54347. Subsequently, the two cases, by the consent of all parties, were consolidated.

In the case of William Albert Harbison, after the issue had been joined, the Commissioner of Internal Revenue filed an amended answer, alleging that the petitioner, William Albert Harbison, had during the taxable year 1928 an "ordinary net income" of $66,367.87, as defined by section 201 (c) of the Revenue Act of 1928, but without any allowance of a deduction for contributions as provided by section 23 (a) of the Revenue Act of 1928; that the total amount of contributions made during the taxable year 1928 by the petitioner to organizations within the provisions of section 23 (n) of the Revenue Act of 1928 was $27,996.83; that William Albert Har-

bison elected to have the gain or loss on the sale of the common stock of the Harbison-Walker Refractories Company taxed under the capital net gain and loss provision of section 101 of the Revenue Act of 1928; that a deduction for contributions in the amount
40 of $16,747.26 was claimed in computing the income on the original return and that in the deficiency letter the full amount of the total contributions made of $27,996.83 was allowed as a deduction and the Commissioner of Internal Revenue, in his amended answer, alleged that he erred in the computation of the amount of contributions allowable as a deduction in that he applied the 15% limitation to the total net income, including the capital gain, whereas the amount of the deductible contributions was alleged by the provisions of the Revenue Act to be limited to 15% of the "ordinary net income" of the petitioner, or to the sum of $9,996.23.

The Board of Tax Appeals decided the other issues involved in the consolidated case in favor of your petitioner, but decided that the charitable contributions of your petitioner should be limited to 15% of the "ordinary net income", excluding therefrom 15% of the "net capital gains", and ordered and decided on March 7th, 1933, that there was a deficiency in the tax for the year 1928 due from the petitioner in the amount of $930.56.

III

Subsequent to the rendering of this decision in the Harbison case, your honorable Board, by its decision on April 6th, 1933, in the case of Aaron Straus vs. The Commissioner of Internal Revenue, Docket No. 65091, overruled its decision in this Harbison case and stated that it, along with two other decisions, would no longer be followed, and held that the contribution deductions, limited to 15% of
41 the net income, to which a taxpayer is entitled under section 23 (n) of the Revenue Act of 1928, is not affected by his election to be taxed in accordance with section 201 (a)—the capital net gain provisions of the act.

IV

Your petitioner, being aggrieved by the conclusions of law in the findings and opinions of your honorable Board, and by its decision rendered pursuant thereto, desires to obtain a review thereof by the Court of Appeals of the Second Circuit.

V

ASSIGNMENTS OF ERROR

Your petitioner assigns as error the following acts and omissions of the Board of Tax Appeals:

1. The failure to allow as a deduction from the petitioner's gross income for the year 1928 the contributions or gifts which he made

exclusively for religious, charitable, scientific, literary or educational purposes to an amount which did not exceed 15% of the taxpayer's net income as computed in accordance with the Revenue Act of 1928.

2. The failure to include the net capital profits of the taxpayer as a basis for the computation of the fifteen per centum of the taxpayer's net income.

3. The holding that "ordinary net income", as used in con-
42 nection with section 101 (a) of the Revenue Act of 1928, means the net income computed in accordance with the provisions of this title after excluding all items of capital gains, capital loss and capital deductions.

4. The holding that when a taxpayer avails himself of the benefit of Section 101 (a), the amount of the taxpayer's capital net gain should be excluded from the amount of his net income upon which to compute the 15% deduction for contributions within the purview of Section 23 (n).

(Signed) J. E. MacCloskey, Jr.,
J. E. MacCloskey, Jr.,
Counsel for Petitioner,
1712 Farmers Bank Building, Pittsburgh, Pennsylvania.

[*Duly sworn to by Wm. Albert Harbison, jurat omitted in printing.*]

43 Before United States Board of Tax Appeals

[Title omitted.]

Statement of the evidence

Filed Sept. 14, 1933

The following is a statement of evidence submitted to the Board of Tax Appeals in the above mentioned case so far as is necessary to the assignments of error as filed, reduced to narrative form:

William Albert Harbison, the petitioner, is a resident of White Plains, New York, and, during the taxable year 1928 had an "ordinary net income" of $66,634.87, as defined by section 101 (c) of the Revenue Act of 1928, but without any allowance for a deduction for contributions as provided by section 23 (n) of the Revenue Act of 1928.

William Albert Harbison, during the taxable year 1928, had a "capital net gain" of $45.013.52, as defined by section 101 (c) of the Revenue Act of 1928, and elected to have this capital net gain taxed under the capital net gain provision, section 101, of the Revenue Act of 1928.

The total amount of contributions made during the taxable year 1928 by William Albert Harbison to organizations within the
44 provisions of section 23 (n) of the Revenue Act of 1928, was $27,996.83.

William Albert Harbison claimed as a deduction for charitable contributions in his tax return so filed the sum of $16,747.26, being an amount which did not exceed fifteen per centum of the sum of his "ordinary net income" and his "capital net gain", and paid a tax of $8,592.08.

(Signed) J. E. MacCloskey, Jr.
(Signed) J. E. MacCloskey, Jr.,
Counsel for Petitioner,
1712 Farmers Bank Building, Pittsburgh, Pennsylvania.

It is hereby stipulated and agreed between the parties to this proceeding, by their respective undersigned attorneys, that the foregoing is a statement of evidence in the above entitled case so far as is necessary to the assignments of error as filed, reduced to narrative form.

J. E. MacCloskey, Jr.,
Counsel for Petitioner.
E. Barrett Prettyman,
General Counsel, Bureau of Internal Revenue.

September 9, 1933.

Approved and ordered filed this 14th day of Sept., 1933.
(S.) Charles P. Smith,
Member.

45 Before United States Board of Tax Appeals

[Title omitted.]

Praecipe for transcript of record

Filed Sept. 16, 1933

To the Clerk of the United States Board of Tax Appeals:

You are hereby requested to prepare, certify, and transmit to the Clerk of the United States Court of Appeals for the Second Circuit, with reference to Petition for Review heretofore filed by the Petitioner in the above cause, the transcript of the record in the above cause, prepared and transmitted as required by law and by the Rules of the said Court, and to include in the said transcript of record the following documents or certified copies thereof, to wit:

1. The docket entries of all proceedings before the Board of Tax Appeals.
2. Pleadings before the Board of Tax Appeals as follows:
(a) Petition for redetermination.
(b) Answer of respondent.
(c) Motion for consolidating case with Docket No. 54346.

46 (d) Motion and amended answer of respondent, filed April 22, 1932, and order thereon of July 13, 1932.

(e) Stipulation of parties as to the facts in the case.

3. Findings of fact and opinion of the Board of Tax Appeals, promulgated August 29, 1932.

4. Decision of the Board, entered March 7, 1933, deciding that there was a deficiency in the tax for the year 1928 due from the petitioner in the amount of $930.56.

5. Petition for review, filed by the petitioner in the above cause.

6. Order, entered July 21, 1933, extending the time for preparation of evidence and transmission and delivery of the record to October 4, 1933.

7. Statement of evidence, as stipulated to and agreed upon.

8. This praecipe.

(Signed) J. E. MacCloskey, Jr.
J. E. MacCloskey, Jr.,
Attorney for Petitioner,
1712 Farmers Bank Building, Pittsburgh, Pa.

[Clerk's certificate to foregoing transcript omitted in
47 printing.]

48 In United States Circuit Court of Appeals

For the Second Circuit

William Albert Harbison, petitioner

v.

Commissioner of Internal Revenue, respondent

Motion for substitution

Comes now the above-named petitioner and moves the court that Guy T. Helvering, Commissioner of Internal Revenue, be substituted for David Burnet, as respondent herein, and in support of said motion respectfully shows;

1. That the resignation of said David Burnet, who was Commissioner of Internal Revenue when the petition for review in this proceeding was filed, was duly accepted and he ceased to be such officer on May 15, 1933.

2. That Guy T. Helvering was duly appointed and confirmed as Commissioner of Internal Revenue to succeed the said David Burnet; that he qualified as such officer and entered upon the duties of said office on June 6, 1933, since which date the said Guy T. Helvering has been and now is Commissioner of Internal Revenue.

3. That there is a substantial need for continuing and maintaining this proceeding and obtaining an adjudication of the questions involved, for otherwise the order of the United States Board of Tax Appeals herein sought to be reviewed will become final and the right to have the legality thereof determined will be extinguished.

This motion is made pursuant to the provisions of section 11 of the act of February 13, 1925, c. 229, 43 Stat. 941 (U.S.C. title 28, sec. 780).

Dated June 7, 1933.

J. E. MacCloskey, Jr.,
Attorney for Petitioner.

The undersigned, attorney for Guy T. Helvering, Commissioner of Internal Revenue, hereby expressly consents to the substitution sought by the above motion.

Sewall Key,
Special Assistant to the Attorney General,
Attorney for Guy T. Helvering,
Commissioner of Internal Revenue.

In United States Circuit Court of Appeals

Order substituting party respondent

Upon motion of the petitioner, expressly consented to by Guy T. Helvering, Commissioner of Internal Revenue, it is hereby

Ordered that said Guy T. Helvering, as such officer, be, and he hereby is, substituted for David Burnet, former Commissioner of Internal Revenue, and that this proceeding be so continued and maintained.

Dated; August 31, 1933. Wm. Parkin, *Clerk.*

49 In United States Circuit Court of Appeals for the Second Circuit

No. 208—October Term, 1933

Argued December 20, 1933. Decided January 8, 1934

William Albert Harbison, petitioner

v.

Commissioner of Internal Revenue, respondent

Appeal from the United States Board of Tax Appeals

Before L. Hand, Swan, and Augustus N. Hand, Circuit Judges

The taxpayer petitions for a review of an order of the Board redetermining a deficiency in income tax for the year 1928. Order reversed.

For the opinion below, see 26 B.T.A. 896.

J. E. MacCloskey, Jr., (Hugh Satterlee, of New York City, of counsel), for petitioner.

Sewall Key and J. P. Jackson, Sp. Assts. to Atty. Gen., for respondent.

Opinion

PER CURIAM:

The question presented is identical with that decided in Bliss v. Commissioner, — F. (2d) —, handed down herewith. For the reasons there stated, the order must be, and is, reversed.

L. HAND, Circuit Judge, dissents.

50 In United States Circuit Court of Appeals,
Second Circuit

WILLIAM ALBERT HARBISON, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals

Judgment

Filed January 15, 1934

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be, and it hereby is, reversed.

It is further ordered that a mandate issue to the said Board in accordance with this decree.

WM. PARKIN, *Clerk.*

51 [File endorsement omitted.]

52 [Clerk's certificate to foregoing transcript omitted in printing.]

53 In Supreme Court of the United States

No. 889. October term, 1933

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

v.

MARY COLGATE

Stipulation

It is hereby stipulated and agreed by and between the parties hereto through their respective attorneys that if this Court grants the petition for a writ of certiorari in the case of Guy T. Helvering v. William Albert Harbison, now pending on a petition for a writ of certiorari, a writ of certiorari shall also be granted in the present

case, and that if the writ of certiorari applied for in the Harbison case is denied, the writ applied for in the present case shall also be denied. If the writ of certiorari applied for in the Harbison case is granted, the parties stipulate and agree that the decision of this Court on the question of law in the Harbison case shall be deemed an adjudication of the same question of law in the present case, and that the parties hereto consent to the entry of judgment in the present case to the same effect as though the decision in the Harbison case were rendered by this Court in the present case. In view of this stipulation, the clerk need not print the record in the present case.

It is further stipulated and agreed by the Solicitor General that he consents to the filing by the attorney for Mary Colgate of a brief as amicus curiae in the Harbison case. The Solicitor General waives notice of a motion for leave to file such a brief, and this stipulation may be taken as a full and complete consent on his part to the filing of such a brief.

It is further stipulated and agreed that if the Harbison case should be decided other than on the merits of the question of law referred to above, the parties herein shall be remitted to their former rights to file briefs and to continue the prosecution of the present case independently of the Harbison case.

J. CRAWFORD BIGGS,
Solicitor General, Counsel for the Petitioner.
CARLYLE E. YATES,
Counsel for Mary Colgate.

MARCH 1934.

54 In Supreme Court of the United States

Order allowing certiorari

Filed April 30, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Endorsement on cover:) File No. 38, 491. U.S. Circuit Court of Appeals, second circuit. Term No. 888. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, *vs.* William Albert Harbison. Petition for a writ of certiorari and exhibit thereto. Filed March 23, 1934. File No. 888 O.T. 1933.

U. S. GOVERNMENT PRINTING OFFICE: 1934

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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

SUSAN DWIGHT BLISS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in the above cause on January 15, 1934, reversing the decision of the Board of Tax Appeals. (R. 31.)

OPINIONS BELOW

The findings of fact and opinion of the Board of Tax Appeals (R. 16–20) are reported in 27 B.T.A. 205. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 26) is not yet reported.

QUESTION PRESENTED

Where the taxpayer elects to be taxed under Section 101 (a) of the Revenue Act of 1928, does the basis for computing the 15% deduction allowable for contributions under Section 23 (n) of the Act include capital net gains or ordinary net income only?

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra,* pp. 9–12.

STATEMENT

This is a proceeding for the redetermination of deficiencies in income taxes for the years 1928 and 1929. It was begun by notice of deficiency sent to the taxpayer by the Commissioner of Internal Revenue relating to certain deductions not here material. (R. 2, 9.) By amended answers to the taxpayer's petitions to the Board of Tax Appeals, the Commissioner set forth as an additional ground for assessment of deficiencies that the taxpayer, having elected to be taxed under Section 101 (a) of the Revenue Act of 1928, had claimed deductions for charitable contributions in excess of the 15% of her new income allowed by Section 23 (n) of the Act. (R. 7–8, 12–13.)

The facts were stipulated, and as so stipulated may be summarized as follows (R. 13–15):

The amount of charitable and other contributions made by the taxpayer during the years 1928 and 1929 of a character deductible from net income sub-

ject to the limitations provided in Section 23 (n) of the Revenue Act of 1928 (*infra,* p. 10), was $43,995.92 (R. 14) for the year 1928, and $39,088.46 for the year 1929 (R. 15). The ordinary net income of the taxpayer before deducting the amounts of such contributions was $270,490.77 for the year 1928 (R. 14) and $247,571.83 for the year 1929 (R. 15). The taxpayer's capital net gain for 1928 was $211,544.82 (R. 14), and for 1929 was $299,942.31 (R. 15).

The taxpayer deducted the respective total amounts of the charitable and other contributions from the respective years' gross income upon the ground that in determining the 15% limitation for charitable deductions under Section 23 (n) of the 1928 Act (*infra,* p. 10) ordinary income and capital net gains should both be included, regardless of her election to be taxed under Section 101 (a) of the Act.

The Commissioner took the position that deductions for contributions should be limited to 15% of the "ordinary net income," excluding "capital net gains" by virtue of the election to be taxed under Section 101 (a). (R. 8, 12–13.) In this he was sustained by the Board of Tax Appeals. (R. 19.) The Circuit Court of Appeals reversed, Judge Learned Hand dissenting. (R. 26–31.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In including the taxpayer's capital net gain for the calendar years 1928 and 1929 in computing

the 15% limitation upon contributions deductible from the taxpayer's gross income for those years, pursuant to Section 23 (n) of the Revenue Act of 1928.

2. In reversing the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The court below has decided a question of general public importance which should be settled by this Court.

The taxpayer elected to have her capital net gains taxed under Section 101 (a) of the 1928 Act (*infra*, p. 10) rather than in the normal manner. Under that section the taxpayer is given the option of having his capital net gain segregated from his ordinary net income and taxed at a flat 12½% rate. Where a taxpayer elects to be taxed under Section 101 (a) his total net income is divided into two separate classes: capital net gains and "ordinary net income". These two classes are computed separately and taxed separately at different rates. When this election is exercised, it was the intent of Congress that the two types of income should be completely segregated and that items coming within one class should not influence the computation of the tax on the other class. The 15% limitation for contribution deductions (which are ordinary deductions under Section 101 (c) (4) (*infra*, p. 11), should consequently not be affected by capital net gains. This purpose of segregation is clearly evidenced by the language of Section 101 (a) (b) and (c) (*infra*, pp. 10–11).

The Treasury Department advises that there are pending in the courts, before the Board of Tax Appeals, and in the Income Tax Unit of the Bureau of Internal Revenue 388 cases involving taxes in the total amount of $2,597,993.02, dependent entirely upon the determination of the question here involved.[1] These figures are entirely exclusive of cases pending in the field. It is known that there are a great many of such cases but it is impossible to estimate either the number or the amount involved.

Moreover, since the statutes here involved appear in all the Revenue Acts from 1921 to 1932, inclusive, the question is one of present importance and it will

[1] Several of these cases have reached the courts. Aside from *Helvering* v. *Harbison*, No. —, October Term, 1933, and *Helvering* v. *Colgate*, No. —, October Term, 1933, petitions for writs of certiorari in which cases are filed simultaneously herewith, one other case has been decided by a Circuit Court of Appeals, contrary to the Commissioner's contention. *White* v. *Atkins*, C.C.A. 1st, decided March 14, 1934, with one judge dissenting, affirming *Atkins* v. *White*, 3. F. Supp. 694 (D. Mass.). The following cases are pending in the various Circuit Courts of Appeals:

Straus v. *Commissioner*, 27 B.T.A. 1116, now pending after argument in the Court of Appeals of the District of Columbia; *Robinette* v. *Commissioner*, 27 B.T.A. 1426, now pending before argument in the Circuit Court of Appeals for the Third Circuit; *Igleheart* v. *Commissioner*, 27 B.T.A. 1426, now pending after argument in the Circuit Court of Appeals for the Seventh Circuit; *Woodward* v. *Commissioner*, 27 B.T.A. 1426, now pending on appeal to the Circuit Court of Appeals for the Second Circuit; *Blow* v. *United States* (N.D.Ill.), decided September 1, 1933, unreported, now pending before argument in the Circuit Court of Appeals for the Seventh Circuit.

arise constantly in the future. A decision by this Court is therefore deemed necessary in order to settle the question with a minimum of expense and delay.

2. The question presented is also of general importance to a large number of taxpayers who have sustained "capital net losses". Section 101 (b) of the Revenue Act of 1928 (*infra*, p. 10) provides that where a taxpayer has sustained a capital net loss, such net loss is to be segregated from ordinary items of net income and the tax is based upon this ordinary net income minus 12½% of capital net loss. It will be noted that this section, where applied, treats capital net losses in the same manner as Section 101 (a) treats capital net gains. In *Elkins* v. *Commissioner*, 24 B.T.A. 572, the Board held that capital net losses should be segregated entirely from ordinary net income and that the allowance for contribution deductions should be computed with reference to the ordinary net income excluding all consideration of capital net losses. This decision was followed in *Livingood* v. *Commissioner*, 25 B.T.A. 585.

The court below noted (R. 28) that the question of proper treatment of capital net losses in determining contribution deductions is identical in principle with the question here involving capital net gains, and that the construction favorable to the taxpayer in this case will operate to the detriment of taxpayers in the case of capital net losses. Consequently, a decision by this Court on the question

here involved will also dispose of the question of proper allowance for contribution deductions in cases of capital net losses.

3. A decision of this Court is also necessary in order to settle the confusion now existing in the administration of the provisions involved. Originally the Bureau of Internal Revenue held that capital net gains and capital net losses should both be included in computing the 15% limitation. I.T. 2104, III-2 Cumulative Bulletin 152. Following the decision of the Board of Tax Appeals in the *Elkins* case, *supra,* the Bureau reversed its ruling, acquiesced in the *Elkins* decision (XI-2 Cumulative Bulletin 3), and held that neither capital gains nor capital losses should be included (Mim. 3931, XI-1 Cumulative Bulletin 33; Mim. 3986, XI-2 Cumulative Bulletin 29; G.C.M. 11324, XI-2 Cumulative Bulletin 267; I.T. 2668, XI-2 Cumulative Bulletin 268). An acceptance of the decision below will leave the matter in further confusion and will necessitate a second reversal by the Bureau. A decision by this Court is requested in order that the question may be settled finally one way or the other.

4. While the decision below is the first decision by any Circuit Court of Appeals on the precise question here presented, the decision apparently conflicts in principle with the decision of the Circuit Court of Appeals for the Fifth Circuit in *Westfeldt* v. *Commissioner,* 63 F. (2d) 882. That case holds that where an individual on a calendar

year basis sustains a capital net loss in 1924 and also reports income from a partnership having a fiscal year ended in 1924, the amount to be placed in the lower brackets of the rate schedule applicable to 1924 under Section 207 (b) of the Revenue Act of 1924 (*infra*, p. 9) is the amount of his ordinary net income undiminished by any part of the capital net loss. The court recognized the principle of segregation invoked by the Commissioner in this case and after discussing the capital net gain and capital net loss provisions of the Act, said (p. 883):

> the capital items thus put under the 12½% flat rate go out of the computation of the taxes under the regular rates, and the "other income" to which partnership gains are to be added is unaffected by the capital items.

Wherefore, it is respectfully submitted that the petition should be granted.

J. CRAWFORD BIGGS,
Solicitor General.

MARCH, 1934.

APPENDIX

Revenue Act of 1924, c. 234, 43 Stat. 253, 261:

SEC. 207. (b) If a fiscal year of a partnership begins in one calendar year and ends in another calendar year, and the law applicable to the second calendar year is different from the law applicable to the first calendar year, then (1) the rates for the calendar year during which such fiscal year begins shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year. In such cases the part of such income subject to the rates in effect for the most recent calendar year shall be added to the other income of the taxpayer subject to such rates and the resulting amount shall be placed in the lower brackets of the rate schedule applicable to such year, and the part of such income subject to the rates in effect for the next preceding calendar year shall be placed in the next higher brackets of the rate schedule applicable to such year.

(U.S.C., Title 26, Sec. 938.)

Revenue Act of 1928, c. 852, 45 Stat. 791, 799, 811:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(n) *Charitable and other contributions.*—In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

* * * * *

(2) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes * * *;

* * * * *

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. * * *.

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) *Tax in case of capital net gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) *Tax in case of capital net loss.*—In the case of any taxpayer, other than a corporation, who for any taxable year sustained a capital net loss (as hereinafter defined in

this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) *Definitions.*—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years * * *

* * * * *

(d) *Collection and payment of tax.*—The total tax determined under subsection (a) or (b) shall be collected and paid in the same manner, at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

U. S. GOVERNMENT PRINTING OFFICE: 1934

In the Supreme Court of the United States

OCTOBER TERM, 1933

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

WILLIAM ALBERT HARBISON

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in the above cause on January 15, 1934, reversing the decision of the Board of Tax Appeals.

OPINION BELOW

The findings of fact and opinion of the Board of Tax Appeals (R. 38–44) are reported in 26 B.T.A. 896. The opinion of the Circuit Court of Appeals for the Second Circuit is not yet reported.

QUESTION PRESENTED

Where the taxpayer elects to be taxed under Section 101 (a) of the Revenue Act of 1928, does the basis for computing the 15% deduction allowable for contributions under Section 23 (n) of the Act include capital net gains or ordinary net income only?

STATEMENT

This case involves deficiencies in Federal income taxes for the year 1928 in the amount of $930.56. (R. 37.)

The facts as stipulated (R. 22–24) and found by the Board of Tax Appeals (R. 26–30) may be summarized as follows:

The taxpayer is a resident of White Plains, New York, and, during the taxable year 1928 had an "ordinary net income" of $66,634.87, as defined by Section 101 (c) of the Revenue Act of 1928, but without any allowance for deduction for contributions as provided by Section 23 (n) of the Revenue Act of 1928.

During the taxable year 1928, the taxpayer had a "capital net gain" of $45,013.52 (R. 43), as defined by Section 101 (c) of the Revenue Act of 1928, and elected to have this capital net gain taxed under the capital net gain provision, Section 101 (a) of the Revenue Act of 1928.

The total amount of contributions made during the taxable year 1928 by the taxpayer to organiza-

tions within the provisions of Section 23 (n) of the Revenue Act of 1928 was $27,996.83. (R. 44.)

The taxpayer claimed as a deduction for charitable contributions in his tax return so filed the sum of $16,747.26, being 15% of the sum of his "ordinary net income" and his "capital net gain."

The Commissioner of Internal Revenue in his amended answer (R. 21) took the position that the contribution deductions should be limited to $9,996.23 or 15% of the "ordinary net income", excluding "capital net gain." The Board of Tax Appeals sustained the Commissioner (R. 35–36) and determined a deficiency of $930.56 (R. 37). The Circuit Court of Appeals for the Second Circuit reversed, on the authority of *Susan Dwight Bliss* v. *Commissioner,* decided January 8, 1934, not yet reported. Judge Learned Hand dissented.

REASONS FOR GRANTING THE WRIT

The question here presented is identical with that presented in *Guy T. Helvering, Commissioner of Internal Revenue,* v. *Susan Dwight Bliss,* No. —, October Term, 1933, petition for a writ of certiorari in which case is being filed simultaneously herewith. For the reasons set forth in the Government's petition in that case, it is respectfully submitted that the petition here should be granted.

J. CRAWFORD BIGGS,
Solicitor General.

MARCH 1934.

U. S. GOVERNMENT PRINTING OFFICE: 1934

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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 6

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

SUSAN DWIGHT BLISS

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and opinion of the Board of Tax Appeals (R. 16–20) are reported in 27 B.T.A. 205. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 26) is reported in 68 F. (2d) 890.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 15, 1934 (R. 31). A petition for a writ of certiorari was filed on March 23, 1934,

and was granted April 30, 1934. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Where the taxpayer elects to be taxed under Section 101 (a) of the Revenue Act of 1928, does the basis for computing the 15% deduction allowable for charitable contributions under Section 23 (n) of the Act include capital net gains, or is it limited to ordinary net income only?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in Appendix A, *infra*, pp 27–34.

STATEMENT

This is a proceeding for the redetermination of deficiencies in income taxes for the years 1928 and 1929. It was begun by notice of deficiency sent to the taxpayer by the Commissioner of Internal Revenue relating to certain deductions not here material. (R. 2, 9.) By amended answers to the taxpayer's petitions to the Board of Tax Appeals, the Commissioner set forth as an additional ground for assessment of deficiencies that the taxpayer, having elected to be taxed under Section 101 (a) of the Revenue Act of 1928, had claimed deductions for charitable contributions in excess of the 15% of her net income allowed by Section 23 (n) of the Act. (R. 7–8, 12–13.)

The facts were stipulated, and as so stipulated may be summarized as follows (R. 13–15):

The amount of charitable and other contributions made by the taxpayer during the years 1928 and 1929 of a character deductible from net income, subject to the limitations provided in Section 23 (n) of the Revenue Act of 1928 (*infra,* p. 28) was $43,995.92 for the year 1928 (R. 14), and $39,088.46 for the year 1929 (R. 15). The ordinary net income of the taxpayer before deducting the amounts of such contributions was $270,490.77 for the year 1928 (R. 14) and $247,571.83 for the year 1929 (R. 15). The taxpayer's capital net gain for 1928 was $211,544.82 (R. 14), and for 1929 was $299,942.31 (R. 15).

The taxpayer deducted the respective total amounts of the charitable and other contributions from the respective years' gross income upon the ground that in determining the 15% limitation for charitable deductions under Section 23 (n) of the 1928 Act, ordinary income and capital net gains should both be included, regardless of her election to be taxed under Section 101 (a) of the Act.

The Commissioner took the position that deductions for contributions should be limited to 15% of the "ordinary net income", excluding "capital net gains", by virtue of the election to be taxed under Section 101 (a). (R. 8, 12–13.) In this he was sustained by the Board of Tax Appeals. (R. 19.) The Circuit Court of Appeals reversed, Judge Learned Hand dissenting. (R. 26–31.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In allowing the taxpayer, for the years 1928 and 1929, to deduct charitable contributions under Section 23 (n) of the Revenue Act of 1928 to the extent of 15% of the sum of her ordinary net income plus her capital net gains.

2. In reversing the Board of Tax Appeals.

SUMMARY OF ARGUMENT

The taxpayer elected to have her capital net gains taxed under Section 101 (a) of the Revenue Act of 1928 (*infra*, p. 28) rather than in the normal manner. Under that section the taxpayer is given the option of having his capital net gain segregated from his ordinary net income and taxed at a flat 12½% rate. Where a taxpayer exercises this option, his total net income is divided into two separate clases: capital net gains and ordinary net income. These two classes are computed separately and taxed separately, at different rates. The controversy in this case is over the computation of taxpayer's ordinary net income.

"Ordinary net income" is defined in Section 101 (c) (7) to mean "the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions." Since, under the plain language of the statute, capital items are to be excluded, they may not be included for the purpose of determining the allowance for charitable con-

tributions, which is one of the ordinary deductions entering into the computation of ordinary net income.

Where Section 101 (a) is invoked, it was the intent of Congress that the two types of income should be completely segregated and that items coming within one class should not influence the computation of the tax on the other class. The 15% limitation for contribution deductions should consequently not be affected by capital net gains. This purpose of segregation is clearly evidenced by the language of the capital gain provisions and their legislative history.

When the election is made to be taxed under Section 101 (a) there is an exception to the general limitation provided by Section 23 (n), and the otherwise general meaning of "net income" becomes modified to mean the taxpayer's "ordinary net income" as used in Section 101 (c). Thus Section 101 (a) is a specific provision dealing with particular situations, and must be interpreted as prevailing over the general language used elsewhere.

Where by invoking the capital net gain provisions the taxpayer succeeds in having his capital gains taxed separately, thereby effecting a substantial reduction in his tax, he should not be heard to complain that his ordinary deductions are somewhat reduced because of the separate computation. He may not have his tax reduced by invoking the rule of segregation and at the same time seek a further reduction on the theory that segregation

should be ignored. He may not exclude capital net gains for the purpose of securing the benefit of a lower rate of tax, and at the same time include capital gains for the sole purpose of securing the maximum deduction for contributions.

Section 101 (b) of the Act (*infra*, pp. 28–29) provides that where a taxpayer sustains a capital net loss, such net loss is to be segregated from ordinary items of net income, and the tax is to be based upon this ordinary net income minus 12½% of the capital net loss. The court below recognized that this section where applicable treats capital net losses in the same manner as Section 101 (a) treats capital net gains. Unless the theory of segregation is applied, it means that taxpayers who have capital net losses may have a net income for the purpose of computing the ordinary tax liability, and at the same time have no net income for the purpose of computing the amount allowable as a deduction for contributions—a conclusion that seems to be at variance with the evident intent of the statute.

ARGUMENT

For the year 1928[1] the taxpayer made charitable contributions aggregating $43,995.92. Such contributions are deductible under Section 23 (n) of the Revenue Act of 1928 (*infra*, p 28) "to an amount which * * * does not exceed 15 per centum of the taxpayer's *net income* as computed

[1] The year 1929 is also involved but the figures for the year 1928 will suffice for illustration.

without the benefit of this subsection." (Italics supplied.) The ordinary net income of the taxpayer before deducting the amount of such contributions was $270,490.77. The capital net gain for such year was $211,544.82. The court below gave the taxpayer the right to deduct charitable contributions to the extent of 15% of the sum of her ordinary net income plus her capital net gain; that is, to the extent of 15% of $482,035.59. It is the Government's position that by virtue of taxpayer's election to be taxed under Section 101 (a) of the 1928 Act (*infra,* p. 28), her deduction for charitable contributions is limited to 15% of her ordinary net income, excluding her capital net gains.

It must be conceded that had the taxpayer elected to be taxed in the normal manner, she would clearly be entitled to the full deduction as allowed by the court below, because "net income" as used in Section 23 (n) (*infra,* p. 28), and as defined in Section 21 (*infra,* p. 28), is broad enough, if unqualified, to cover "capital net gains." But instead of being taxed in the normal manner, the taxpayer elected to be taxed under the "capital net gain" provisions, which prescribe an entirely different method of taxation. Under this method a taxpayer's total net income is divided into two separate classes: capital net gains and ordinary net income. These two classes are computed separately and taxed separately, at different rates.

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This departure from the normal method of taxation is set forth in Section 101 (a) of the Act, which provides:

> *Tax in case of capital net gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, *at the election of the taxpayer,* be levied, collected, and paid, *in lieu of all other taxes imposed by this title,* a tax determined as follows: a partial tax shall first be computed upon the basis of the *ordinary net income* at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain. [Italics supplied.]

It is to be noted that under this section instead of applying normal and surtax rates to "net income" as defined in Section 21, the said rates are applied to "ordinary net income." A partial tax is *first* to be computed on *ordinary net income,* and the total tax is this amount plus 12½% of the capital net gain.

There is no dispute in this case over the 12½% tax on the taxpayer's capital net gain; the controversy is over the amount of the taxpayer's "ordinary net income." The question is whether, in computing "ordinary net income", charitable contribution deductions are to be allowed to the extent of 15% of the taxpayer's ordinary net in-

come plus her "capital net gains", or to the extent, only, of 15% of her "ordinary net income."

"Ordinary net income" is defined by Section 101 (c) (7) of the Act as meaning—

> * * * the net income, computed in accordance with the provisions of this title, after *excluding all items of capital gain, capital loss, and capital deductions.* (Italics supplied.)

It seems to us, just as it appeared to Judge Learned Hand, who dissented from the opinion of the court below (R. 30–31), and to Judge Morton, who dissented in *White* v. *Atkins* (C.C.A. 1st), decided March 14, 1934, 69 F. (2d) 960, that the above language is " too plain for latitude of interpretation " (R. 30). Congress commanded that in the computation of " ordinary net income " all capital gains, capital losses, and capital deductions should be excluded. Since these items must be *excluded* in the computation, then clearly they may not be *included,* even for the purpose of computing the charitable contribution deduction, which is one of the ordinary deductions entering into the computation of " ordinary net income."

As pointed out in the dissenting opinion below (R. 30–31), Section 23(n) puts a limit upon charitable gifts of "15 per centum of the taxpayer's net income *as computed without the benefit of this subsection.*" This section requires two computations: first, a computation of net income, omitting all charitable gifts. That gives a tentative net in-

come, or a basis for computing charitable deductions; all charitable gifts may then be deducted until they reach the prescribed limit, which is 15% of the basis first computed. Thus the final taxable income is computed in two steps.

The problem here is to determine "ordinary net income." "Ordinary net income" is to be "computed in accordance with the provisions of this title" (Sec. 101 (a) (7)), which, as regards charitable gifts, means that two steps must be taken: first, the determination of the basis upon which to compute the charitable contribution deductions; second, the deduction of the gifts to the extent of 15% of such basis. However, "ordinary net income" is to be computed only after excluding capital items—and "excluding" must necessarily relate to the computation of the basis as well as to the final computation. It would be very unreal to suppose that "excluding" meant that the capital items were first to be included in the computation of the basis; that after they had been included, and 15% of the net result deducted, the same items should be reversed—the gains subtracted and the losses added. That would not be "excluding" them from the computation; "excluding" means dealing with them once and for all.

We submit that the decision below not only ignores the plain language of the statute defining "ordinary net income", but violates the plain purpose of Congress that when an election is made to be taxed under Section 101 (a), all capital items

should be segregated completely from ordinary items of income. The capital items form one distinct class; the ordinary net income items constitute an entirely different class. The tax on these two classes is computed separately, at different rates. It was not intended under this theory of segregation that items of one class should affect the computation of the tax on the other. This purpose of Congress is clearly shown by the above definition of "ordinary net income", which requires that all items of capital gains, capital losses, and capital deductions be excluded in making the computation.

This purpose is further shown from the definition of "capital net gain" in Section 101 (c) (5) (*infra*, p. 29). That subdivision provides that—

> "Capital net gain" means the excess of the total amount of *capital gain* over the sum of (A) the *capital deductions* and *capital losses*, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

"Capital gain", as defined in Section 101 (c) (1), is an item that, except for the capital gain provisions, would fall within the broad meaning of "gross income" as defined in Section 22 (*infra*, p. 27). "Capital loss" and "capital deductions" as defined in subdivisions (2) and (3), respectively, of Section 101 (c), are items that, except for Section 101 (a), would fall within the ordinary deductions specified in Section 23 (*infra*, p. 28). These

various items ordinarily enter into the computation of net income under Section 21 (*infra*, p. 27), but when Section 101 (a) is invoked, these capital items are eliminated and given separate classifications. Thus it is entirely clear that under the method prescribed in Section 101 (a) two classes of income are set up: all items of ordinary net income are set up in one class, and taxed at normal and surtax rates; and all capital items, eliminated from ordinary net income, are separated into another class and taxed at a flat 12½% rate.[2] The intent is clear that items in one class are not meant to affect, or figure in the computation of, the tax on another class. No items of ordinary income or deductions enter into the computation of capital net gain; and, conversely, capital items are specifically excluded in computing the ordinary net income.

This purpose of complete segregation is further shown by the provision in Section 101 (c) (5), that where the ordinary deductions exceed ordinary gross income, this difference (or ordinary net loss) shall go to reduce the capital net gain. Even in that case this ordinary net loss is limited to the amount by which the ordinary deductions (excluding capital losses and capital deductions) exceed the gross income "computed without including cap-

[2] The tax returns prescribed by the Internal Revenue Bureau make provision, where the election is exercised, for the separate reporting of these two classes of income, and for the separate computation of the tax thereon.

ital gains"—again showing the complete severance of capital items from ordinary items of income.

In further support of this purpose is Section 101 (d) (*infra,* p. 30), which provides:

> The total tax determined under subsection (a) or (b) shall be collected and paid in the same manner, at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

There would be no need to add this provision if the tax on capital net gains was, in the mind of Congress, anything but a separate tax.

That it is an entirely separate tax is also shown by the ruling that the personal exemption allowed by Section 25 of the 1928 Act is not applicable to reduce the tax on capital net gains. Indeed, the discrimination shown by Congress in allowing the credits under Section 131 to apply against the capital gain tax, while those under Section 25 do not so apply, is significant. See Article 501, Regulations 74, *infra,* p. 31.

That Congress intended a complete segregation of the two types of income is further shown by the legislative history of the capital net gain provisions, which appeared for the first time in the Revenue Act of 1921. This segregation theory was urged upon Congress in testimony before the Congressional committees. For the convenience of the Court the pertinent parts of these Committee Hearings are set forth in Appendix B (*infra,* pp.

35–38). That this theory of complete segregation was adopted by Congress when the 1921 Act was passed is shown by the 1921 Revenue Bill (H.R. 8245) in its various forms, by the Reports of the House Ways and Means Committee and the Senate Finance Committee, and by the Conference Report on the bill, which are set forth in Appendix C (*infra,* pp. 39–43). From these reports it will be seen that Congress recognized that the gain on the sale of a capital asset, since it represents increment over a series of years, is unlike ordinary income earned within the current taxable year, and because of this difference it proposed to tax the two types of income in an entirely different manner. Instead of ignoring capital gains entirely, as in Great Britain (See S. Rep. No. 275, 67th Cong., 1st Sess., pp. 12–13, *infra,* p. 41), the purpose was to segregate the capital transactions from ordinary transactions and to tax them separately, at different rates.

This theory of segregation was recognized by the Circuit Court of Appeals for the Fifth Circuit in *Westfeldt* v. *Commissioner,* 63 F. (2d) 882. There it was held that where an individual on a calendar-year basis sustains a capital net loss in 1924 and reports income from a partnership having a fiscal year ended in 1924, the amount to be placed in the lower brackets of the rate schedule applicable to 1924, under Section 207 (b) of the Revenue Act of 1924 (*infra,* p. 30) is the amount of his ordinary net income, undiminished by any part of the capital net loss. The court recognized the

principle of segregation, and, after discussing the capital net gain and capital net loss provisions, said (p. 883):

> * * * the capital items thus put under the 12½% flat rate go out of the computation of the taxes under the regular rates, and the "other income" to which partnership gains are to be added is unaffected by the capital items.

We submit that in view of the plain language of the statute, and considering the legislative history of the provisions involved, Congress intended the two types of income should be completely segregated; that items coming within the one class should not influence the computation of the tax on the other class; and that the 15% limitation on contribution deductions must be computed solely with reference to ordinary net income, "excluding all items of capital gain, capital loss, and capital deductions." (Section 101 (c) (7).)

It is true that in computing the 15% limitation on charitable deductions, Section 23 (n) allows 15% of the "net income" (which except for Section 101 (a) would include capital net gain). But that provision is general and appeared in the revenue laws before the specific capital gain provisions here involved were enacted.[3] The capital gain provisions

[3] The 15% limitation on contribution deductions first appeared in Section 214 (a) (11) of the Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1068), whereas the capital gain provisions made their first appearance in Section 206 of the Revenue Act of 1921 (c. 136, 42 Stat. 227, 232).

made a basic change in the method of computing and reporting taxable income. These provisions are not operative in all cases, but only in those instances where the taxpayer elects to avail himself thereof. Where the taxpayer elects to be taxed by the orthodox method, the orthodox definition of "net income" applies; but where the new method is chosen, the specific provisions dealing with the particular situation must be interpreted as prevailing over the general language elsewhere. *Townsend* v. *Little,* 109 U.S. 504, 512; *Rodgers* v. *United States,* 185 U.S. 83, 88, 92; *Kepner* v. *United States,* 195 U.S. 100, 125. Where the specific capital gain provisions are invoked, there is an exception to the general limitation provided by Section 23 (n), and the otherwise general meaning of "net income" becomes modified to mean the taxpayer's "ordinary net income" as defined in Section 101 (c) (7). "Ordinary net income" is "net income" as defined in Section 21, with only this difference: that all capital items are eliminated, and taxed separately. "Ordinary net income" becomes the taxpayer's net income for the specific purpose of computing the ordinary tax liability. Sections 11 and 12 of the 1928 Act (*infra,* p. 27) levy a normal tax and a surtax on the taxpayer's "net income", but where the capital gain provisions are applied, "net income" as used in those sections is taken to mean "ordinary net income." Correspondingly, "net income" as used in Section 23 (n) and elsewhere

in the Act is also to be taken as referring to "ordinary net income." The significant thing is that under this method "net income" as defined in Section 21 disappears and its place is taken by "ordinary net income."

It cannot be said, therefore, that merely because no change was made in the general language of the statute when the capital gain provisions were enacted, such provisions were not intended to effect a change. Admitting that there is no change where the taxpayer does not elect to come under the capital gain provisions, yet where he elects to be taxed thereunder he should take the burdens, whatever they are, with the benefits. Here, by invoking the capital net gain provisions and having her capital gains taxed separately, the taxpayer has effected a saving of over $25,000.[4] She should not, therefore, be heard to complain that her ordinary deductions are somewhat reduced because of the separate computation. As pointed out by Judge Morton in his dissenting opinion in *White*

[4] It will be remembered that the taxpayer's ordinary net income for the year 1928 was $270,490.77, while her capital net gain was $211,544.82, thus throwing her income into the higher surtax brackets. The normal tax and the surtax on these capital net gains, had they been included in the ordinary net income and taxed in the regular manner, would have been 25% of such capital net gains. Sections 11 and 12 of the 1928 Act (*infra*, p. 27). Under the capital net gain provisions the tax on such net gains is only 12½%. Thus, in exercising her option to be taxed under Section 101 (a), taxpayer has cut the tax on such gains to the extent of approximately $25,000.

v. *Atkins, supra,* the taxpayer cannot *exclude* capital gain from gross income for the purpose of getting the lower rate thereon and at the same time *include* capital gain in gross income for the purpose of computing the maximum deduction for contributions.

That we are correct in our position is clearly demonstrated, we submit, when we consider the case of a capital net loss. Section 101 (b) of the 1928 Act (*infra,* p. 28) provides that where a taxpayer has sustained a capital net loss—

> * * * there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

It will be noted that this section, where applied, treats capital net losses in the same manner that Section 101 (a) treats capital net gains. Had the taxpayer in this case sustained a capital net loss of $200,000, and had she an ordinary net income of $200,000 (before deducting her contributions), it would seem altogether clear that such capital net loss, being segregated under Section 101 (b) from ordinary net income, should not figure in the

computation of the contribution deductions under Section 23 (n). If the capital net losses were not separated from the ordinary net income, it would mean that the taxpayer, for the purpose of computing the ordinary tax, would have an ordinary net income of $200,000, subject to the normal rates, and at the same time have no net income for the purpose of computing the amount allowable as a deduction for contributions. However, it seems entirely clear to us that, consistently with the treatment of capital net gains,[5] capital net losses should be segregated entirely from ordinary net income, and that in the supposed case the allowance for contribution deductions should be computed with reference to the ordinary net income, excluding all consideration of capital net losses. The Board of Tax Appeals so held in *Elkins* v. *Commissioner,* 24 B.T.A. 572, and Judge Morton in his dissenting opinion in *White* v. *Atkins, supra,* thought that the reasoning of the *Elkins* case was unanswerable.

The various decisions on this question present a number of conflicting views. The first decision in point is that of *Elkins* v. *Commissioner, supra,* which arose in connection with the capital net loss provisions. That decision is in conformity with the position taken by the Government in this case. It was followed by the Board in the case of *Livingood*

[5] The court below, as well as the First Circuit in *White* v. *Atkins*, *supra*, thought that the same treatment should be accorded capital net losses as is accorded capital net gains.

v. *Commissioner,* 25 B.T.A. 585, which also dealt with a capital net loss. The first case dealing with a capital net gain was *Harbison* v. *Commissioner,* 26 B.T.A. 896 (reversed, 68 F. (2d) 1004 (C.C.A. 2d)). There the Board followed the principle of segregation as recognized in the *Elkins* decision and held that the base for contribution deductions under Section 23 (n) was ordinary net income, excluding capital net gains. This decision was followed by the Board in *Colgate* v. *Commissioner,* 27 B.T.A. 506 (reversed, C.C.A. 2d, unreported), and in the instant case, 27 B.T.A. 205, in both of which cases the principle was recognized.[6]

But the Board changed its position, and in *Straus* v. *Commissioner,* 27 B.T.A. 1116, on identical facts, held that capital net gains should be included in the base for computing contribution deductions.[7] The later cases on the question all follow largely the reasoning of the Board in the *Straus* case.[8]

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[6] The *Harbison* and *Colgate* cases are now pending on writs of certiorari in this Court, Nos. 7 and 8, respectively, October Term, 1934.

[7] The *Straus* case is now pending after argument, on the Commissioner's appeal, in the Court of Appeals for the District of Columbia.

[8] *Robinette* v. *Commissioner,* 27 B.T.A. 1426, now pending after argument in the Circuit Court of Appeals for the Third Circuit; *Igleheart* v. *Commissioner,* 27 B.T.A. 1426, now pending after argument in the Circuit Court of Appeals for the Seventh Circuit; *Woodward* v. *Commissioner,* 27 B.T.A. 1426, now pending on appeal to the Circuit Court of Appeals for the Second Circuit; *Blow* v. *United States*

Following the suggestion of the Board in the *Straus* case, the decision below is predicated largely upon the proposition that the obvious purpose of Section 23 (n) was to encourage gifts for charity and the like, and that there is nothing in the capital gain provisions to indicate that taxpayers were intended to lose any part of the deduction allowed by Section 23 (n). However, it is submitted that the Revenue Act of 1921 made a distinct change in the method of reporting and computing taxable income. That Act introduced a distinction not theretofore recognized in income taxation between ordinary income and a profit on the sale of a capital asset, which, as Judge Morton pointed out in his dissenting opinion in *White* v. *Atkins, supra,* is not income in the usual sense of the word. Congress recognized that a capital gain, while realized in the year of sale, is, unlike ordinary net income, not earned during the taxable year, but, rather, is the result of gradual enhancement in the value of the property over a series of years. It was because of this difference that Congress accorded preferential treatment to capital net gains. See Committee Reports on the 1921 Revenue Bill (Appendix C, *infra,* pp. 40–43). See also *Burnet* v. *Harmel,* 287 U.S. 103. The taxing Acts generally take into consideration only the operations of the current year. The deductions al-

(N.D.Ill.), 5 F. Supp. 737, now pending after argument in the Circuit Court of Appeals for the Seventh Circuit; *White* v. *Atkins, supra.*

lowed under the statutes generally represent expenses paid or accrued on losses suffered during the same taxable year covered by the statute. Cf. *Woolford Realty Co.* v. *Rose*, 286 U.S. 319. And so it is with charitable contribution deductions. Congress apparently intended to allow a taxpayer to deduct contributions to the extent of 15% of his current income. But since a capital gain represents, not ordinary current income, but rather, unrealized earnings of prior years,[9] there appears to be no reason why the charitable deductions for one particular year should be measured by these unrealized earnings of prior years. Congress, itself, has made the distinction by giving capital net gains separate classification, and, we submit, the distinction should be preserved. Charitable deductions should be based on current income, that is, on the "ordinary net income." In any event, the argument appears to lose sight of the fact that while Congress may have intended to encourage charitable contributions, it also fixed a definite limit to the amount deductible. The argument begs the question, for the problem here is the extent of the express limitation. Moreover, this argument also loses sight of the doctrine that deductions are purely matters of legislative grace and are not allowable as of right.

[9] The property sold must have been held for more than two years before it is recognized as a capital asset. Section 101 (c) (8), *infra*, p. 30.

The Circuit Court of Appeals for the First Circuit in *White* v. *Atkins, supra,* following the suggestion of the Board in the *Straus* case, *supra,* made much of the placing of a comma in Section 101 (c) (7). It will be recalled that that section defines "ordinary net income" to mean "the net income, computed in accordance with the provisions of this title, *after excluding all items of capital gain, capital loss, and capital deductions.*" (Italics supplied.) It is said that because the phrase "computed in accordance with the provisions of this title" is set off by commas it must be taken to modify net income, which, as defined in Section 21, includes capital net gains. From this it is argued that "net income", as defined in Section 21, is first computed, and then, and thereafter, the capital items are eliminated in determining ordinary net income. But this contention ignores entirely the succeeding phrase of the section, which commands that the computation be made *after* excluding all capital items. See also p. 7, *supra.* In any event, the capital net gain provisions are to be considered in their entirety, and when so considered, we submit, they show a design to classify separately the two types of income. This purpose, running through all the provisions, cannot be affected by the mere placing of a comma in one of the subdivisions. Punctuation is no part of the statute in such circumstances. *Hammock* v. *Loan and Trust Co.,* 105 U.S. 77, 84. "In the construc-

tion of statutes the rules of grammar are less important than the intention of the legislature." *Singer Manuf'g. Co.* v. *M'Collock*, 24 Fed. 667, 668 (C.C., E.D.Ark.)

Both the court below, in the instant case, and the First Circuit, in the *Atkins* case, placed considerable reliance upon the alleged long-continued administrative construction of the statute, and relied upon the oft-cited rule that the reenactment of a statute without change should be taken as implied approval of previous administrative interpretation. For this interpretation the court below referred to a telegram sent by the Deputy Commissioner to a taxpayer under date of February 6, 1923. This telegram was never published. Reference is also made to I.T. 2104, III–2 Cumulative Bulletin 152. The latter ruling dealt with capital net losses. These earlier rulings did not represent the uninterrupted Treasury interpretation of the statute. Following the *Elkins* decision by the Board (the first decision on the question), the Commissioner accepted the Board's theory of segregation and published official rulings in accordance therewith. See Mim. 3931, XI–1 Cumulative Bulletin 33, Mim. 3986, XI–2 Cumulative Bulletin 29; G.C.M. 11324, XI–2 Cumulative Bulletin 267; I.T. 2668, XI–2 Cumulative Bulletin 268. Thus, following the *Elkins* decision, the Bureau's position has been entirely consistent with the position taken in this case. This position is also consistent with that taken by the Board in the *Livin-*

good, Harbison and *Colgate* cases, *supra*, and with that taken in the instant case. In none of these cases was the Board disturbed by earlier inconsistent Bureau practice. The *Elkins* decision was handed down November 3, 1931. Mim. 3931, XI–1 Cumulative Bulletin 33, *supra,* was published January 27, 1932, and it specifically held that the 15% limitation on the deduction for contributions shall be computed upon the basis of the taxpayer's net income, excluding capital net gain. The Revenue Act of 1932, c. 209, 47 Stat. 169, which reenacted without substantial change the capital net gain provisions here involved (Section 101), was not passed until June 6, 1932. It would seem more logical to say that Congress has impliedly approved the published decision of the Board in the *Elkins* case and the published ruling of January 27, 1932, than to say that it has impliedly approved the unpublished telegram relied upon by the court below. In any event, the earlier inconsistent Treasury rulings have no more force than the reasoning given to sustain them. *Burnet* v. *Chicago Portrait Co.*, 285 U.S. 1, 21.

We submit that the reasoning of the Board in the *Elkins, Harbison,* and *Colgate* cases, *supra,* and the reasoning of the dissenting opinion of Judge Learned Hand in the instant case and of Judge Morton in the *Atkins* case, *supra,* are to be preferred over the reasoning in the *Straus* and later cases.

As already set forth, if the decision below is sustained, it will mean that taxpayers who derive capital net gains and elect to be taxed under Section 101 (a) will not only receive the benefit of a lesser tax on their capital net gains, but will also have the benefit of including those self-same capital net gains in the computation of the ordinary net income deduction for contributions (that is, having the capital net gains added to the base for computing the 15% limitation on contributions), as though such election had not been made under Section 101 (a) of the Act.

We respectfully urge that in cases where Section 101 (a) is applied, the taxpayer's two classes of income must be completely segregated and the capital items must not enter into the computation of ordinary deductions.

CONCLUSION

It is respectfully submitted that the decision of the court below should be reversed.

J. CRAWFORD BIGGS,
Solicitor General.
FRANK J. WIDEMAN,
Assistant Attorney General.
JAMES W. MORRIS,
J. P. JACKSON,
Special Assistants to the Attorney General.

SEPTEMBER 1934.

APPENDIX A

Revenue Act of 1928, c. 852, 45 Stat. 791, 795, 796, 797, 799, 811:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax equal to the sum of the following:

[Here follows list of rates.]

SEC. 12. SURTAX ON INDIVIQUALS.

(a) *Rates of surtax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows:

[Here follows list of rates.]

PART II.—COMPUTATION OF NET INCOME

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on

for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(n) *Charitable and other contributions.*—In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

* * * * *

(2) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes * * *;

* * * * *

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. * * *

* * * * *

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) *Tax in case of capital net gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) *Tax in case of capital net loss.*—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) *Definitions.*—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years* * *.

* * * * *

(d) *Collection and payment of tax.*—The total tax determined under subsection (a) or (b) shall be collected and paid in the same manner, at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

Revenue Act of 1924, c. 234, 43 Stat. 253, 262:

SEC. 207. (b) If a fiscal year of a partnership begins in one calendar year and ends in another calendar year, and the law applicable to the second calendar year is different from the law applicable to the first calendar year, then (1) the rates for the calendar year during which such fiscal year begins shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling

within such calendar year bears to the full fiscal year. In such cases the part of such income subject to the rates in effect for the most recent calendar year shall be added to the other income of the taxpayer subject to such rates and the resulting amount shall be placed in the lower brackets of the rate schedule applicable to such year, and the part of such income subject to the rates in effect for the next preceding calendar year shall be placed in the next higher brackets of the rate schedule applicable to such year. (U.S.C., Title 26, Sec. 938.)

Treasury Department Regulations 74 (promulgated under the Revenue Act of 1928):

ART. 261. *Contributions or gifts by individuals.*—Contributions or gifts made within the taxable year by an individual are deductible to an aggregate amount not in excess of 15 percent of the taxpayer's net income (including such payments), if made to or for the use of:

[Here follow descriptions of donees.]

ART. 501. *Definition and illustration of capital net gain.*—Section 101, which applies to sales and exchanges of capital assets consummated after December 31, 1921, provides that any taxpayer other than a corporation may, if he so desires, state separately in his return his net gain on sales or exchanges of capital assets, and pay on such capital net gain (as defined and limited in the section) a tax of 12½ percent of the capital net gain in lieu of the tax he would otherwise pay on such income under sections 11, 12, 102, and 211. The tax upon his net income from other sources, termed "ordinary net income," is to be computed at the rates and in the manner provided in sections 11, 12, 102, and 211. The total tax will be the sum

of the tax upon the ordinary net income plus 12½ percent of the capital net gain.

* * * * *

"Capital gain" is taxable gain from the sale or exchange of capital assets consummated after December 31, 1921. "Capital loss" is deductible loss resulting from the sale or exchange of capital assets. See article 591 for the basis for determining such gain or loss, and article 561 as to adjustments for improvements, depreciation, and other items. "Capital deductions" are deductions properly allocable to or chargeable against capital assets sold or exchanged during the taxable year. "Capital net gain" is the excess of the total amount of capital gain over the sum of (1) capital deductions and capital losses, and (2) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gain.

* * * * *

The credit for taxes allowed by section 131 (see articles 691–698) is a credit against the total tax, however computed, but the credits allowed by section 25 are allowed "for the purpose of the normal tax only" and may not be taken against capital net gain, although they may be deducted from "ordinary net income" in computing the amount of the tax.

* * * * *

ART. 502. *Returns of capital net gain.*— Segregation of transactions for the purposes of section 101 (a) is required only where the taxpayer elects to be taxed under that subdivision. When a taxpayer elects to be taxed under section 101 (a) for any taxable

year, he must attach to his return of income for such year an accurate statement under oath showing all items of capital gain, capital loss, and capital deductions in such manner as will clearly show the exact amount of his capital net gain for the taxable year. Each transaction must be separately shown and the capital items with respect thereto grouped together in order that the capital gain derived or the capital loss sustained from each capital transaction will readily appear. In the case of sales or exchanges of securities or any other property, the statement must show how long the property was held by the taxpayer immediately preceding the sale or exchange.

ART. 503. *Capital net losses.*—Section 101 (b) provides for the determination of the tax in the case of any taxpayer (other than a corporation, but including the members of a partnership, an estate or trust, or the beneficiaries thereof) who in any taxable year sustains a capital net loss. A "capital net loss" is the excess of the sum of the capital losses plus the capital deductions as defined in article 501, over the total amount of capital gain as therein defined. It is to be noted that, while the tax provided in section 101 (a) in the case of a capital net gain is to be imposed at the election of the taxpayer, the limitation with respect to a capital net loss provided in section 101 (b) will be applied irrespective of the taxpayer's election.

In the case of any taxpayer, other than a corporation, who sustains a capital net loss for any taxable year, there shall be levied, collected, and paid, in lieu of the normal tax and the surtax imposed by sections 11, 12, 102, and 211, a tax determined as follows:

A partial tax will first be computed upon the basis of the ordinary net income, as defined in section 101 (c) (7) and article 501, at the rates and in the manner provided in sections 11, 12, 102, and 211, and the total tax will be this amount minus 12½ percent of the capital net loss, but in no case shall the tax under section 101 (b) be less than the tax computed without regard to the provisions of section 101.

APPENDIX B

Hearing before the Committee on Ways and Means, 67th Cong., 1st Sess. (December 20, 1920), pp. 131–132, 133, 136:

> Mr. LONGWORTH. Your theory is that the sale of capital assets and the profits resulting therefrom is not the same as the ordinary course of business which produces a profit?
>
> Mr. KELLOGG. That theory is recognized in England, and, I believe, in Canada, today. They have no such tax in England.
>
> * * * * *
>
> Mr. KELLOGG. You have seen what I was going to suggest as one thing subject to the approval of the committee as a way of dealing with this situation, *that all of those things should be segregated into one item and subjected to a flat tax.* You have foreseen exactly what was in my mind.
>
> Mr. LONGWORTH. I have thought a good deal along those lines.
>
> * * * * *
>
> Mr. LONGWORTH. It would be conceivable to my mind that a tax as low as 10 or 15 percent would raise more revenue on these transactions than we are getting now, simply from your statement, which is corroborated in many quarters.
>
> * * * * *
>
> Mr. GREEN. If we would put it on a percentage basis, however, in many cases it would be altogether too high, because it

would operate simply as a sales tax. In other cases it would be too low.

Mr. KELLOGG. *It would not if you adopt the suggestion that Mr. Longworth and I were mentioning a moment ago—if you segregated all those things,* whether they amounted to $1,000 profit or $1,000,000 profit, and fixed a flat percentage of that particular profit as the tax which should be payable by the taxpayer.

* * * * *

Mr. KELLOGG. I would do that in this way: *I would make a segregated flat tax on the amount of profits derived from the transactions*—only make it just as low as your experience and your technical advisers think it is proper to make it, because the lower you make it the more transactions you will encourage. That is the only thing I would suggest. (Italics supplied.)

Internal-Revenue Hearings before the Committee on Finance, United States Senate, 67th Cong., 1st Sess. (May 9–27, 1921), on the Proposed Revenue Act of 1921, pp. 539, 544:

Mr. KELLOGG. * * *

* * * I ask this committee to consider what I have called the *segregation* plan * * *.

Fix a time which seems to you reasonable as *distinguishing between ordinary transactions and real investment transactions.* It seems to me a short time is ample for that—six months, for instance, but call it a year—* * * if a man has held property for more than a year and sells or exchanges it, that shall be called *an extraordinary transaction or a capital transaction, or whatever name you please to give it, so long as it is segregated. Put that transaction in*

one column and put any other similar transaction in the same column. Do not subject it to the normal tax or surtax, but a *flat tax.* * * *. I do not think it ought to be more than 10 percent at the outside. * * * *Make everybody pay identically the same tax on the same class of transactions. Put all the rest of your income into the general return, and add this 10-percent tax on this special transaction to the total amount derived from the other taxation branches of income,* and the total will represent the tax obligations to the Federal Government for that taxable year. (Italics supplied.) (Page 544.)

Mr. KELLOGG. * * *

* * * * *

The subject I am discussing, Senator Calder, is the subject of the sale of capital proceeds and the sale of capital assets, and I have attempted to maintain the thesis that those transactions should be *segregated from general taxation* and subjected to a flat tax of not more than 10 percent. (Italics supplied.)

Hearings before the Committee on Finance, United States Senate, 67th Cong., 1st Sess. on H.R. 8245 (Revenue Bill of 1921) September 1–October 1, 1921, pp. 36–37:

Dr. ADAMS. This section 207 was adopted by the House in the belief that a great many important transactions in the way of the sale of capital assets are now being held up or blocked by the heavy rates of taxation. You will see the effect of it by an illustration. For instance, if a man buys a farm and holds it for 8 years, and it increases in value, and he sells it, all the gain is treated or taxed as of that one year, although in one sense of

the word it was accruing during the 8 years that he held it. Still, in that one year his gain puts him in the high surtax class. Under this section a capital gain will be taxed only at the same rate as is applied to corporations, namely, 12½ percent. That is the theory of the section. * * *

* * * * *

Senator SMOOT. Do I understand that if it is an individual all he has to pay is the 12½ percent corporation tax, and over and above that do you exempt him from paying an income tax?

Dr. ADAMS. You simply *set aside from his ordinary income this capital income*, and the rate on the capital income is limited to 12½ percent. The same limit is placed on losses.

Senator SMOOT. That is to say, he makes $10,000 profit on the sale of the house; and upon the $10,000 he pays 12½ percent and no other tax?

Dr. ADAMS. And no other tax.

Take this illustration: Suppose a man has an ordinary income of $20,000 a year. He sells a farm and makes $80,000. That would give him an income for that year of $100,000. Under existing law he would pay about 30 percent, on the average, on that. What is proposed is this: *Have him set $20,000, his regular income, aside.* That is put *in one class.* Have him *set $80,000 aside in another class. Then compute the tax on the ordinary income of $20,000 in the usual way,* and on the $80,000 he would also pay 12½ percent. (Italics supplied.)

APPENDIX C

Legislative history of the capital net gain provisions, being the pertinent parts of the 1921 Revenue Bill in its various forms [10] and the Committee Reports thereon:

Section 206 (b) of the House bill was as follows:

> In the case of any taxpayer (other than a corporation) whose ordinary net income and capital net gain together exceed $29,000, there shall be levied, collected, and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows:
>
> A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per centum of the capital net gain, or minus 12½ per centum of the capital net loss, as the case may be; but in no such case where the taxpayer derives a capital net gain, shall the total tax be less than 12½ per centum of the total net income. The total tax thus determined shall be levied, collected, and paid at the same time and in the same manner and subject to the same provisions of law, including penalties, as other taxes under this title.

[10] The pertinent parts of the Bill in its various forms are taken from the Conference Print on H.R. 8245 (Revenue Bill of 1921), 67th Cong., 1st Sess., pp. 22–23.

The House Ways and Means Committee report on the Bill was as follows (H. Rep. No. 350, 67th Cong., 1st Sess., pp. 10–11):

> SECTION 206. The sale of farms, mineral properties, and other capital assets is now seriously retarded by the fact that gains and profits earned over a series of years are under the present law taxed as a lump sum (and the amount of surtax greatly enhanced thereby) in the year in which the profit is realized. Many such sales, with their possible profit taking and consequent increase of the tax revenue, have been blocked by this feature of the present law. In order to permit such transactions to go forward without fear of a prohibitive tax, the proposed bill, in section 206, adds a new section (207) to the income tax, providing that where the net gain derived from the sale or other disposition of capital assets would, under the ordinary procedure, be subjected to an income tax in excess of 15 percent, the tax upon capital net gain shall be limited to that rate. It is believed that the passage of this provision would materially increase the revenue, not only because it would stimulate profit-taking transactions but because the limitation of 15 percent is also applied to capital losses. Under present conditions there are likely to be more losses than gains.

The Senate Bill was as follows:

> SEC. 206 (b). In the case of any taxpayer who for any taxable year derives a capital net gain, such capital net gain shall, under regulations prescribed by the Commissioner with the approval of the Secretary, *be stated separately from the ordinary net income in the taxpayer's return;* and only 40 per centum of such capital net gain shall be taken

into account in determining the amount of the net income upon which taxes are imposed by sections 210, 211, and 230 of this title. (Italics supplied.)

The Senate Finance Committee Report was as follows (S. Rep. No. 275, 67th Cong., 1st Sess., pp. 12–13):

Section 206 limits the rate of taxation upon gain derived from the sale of capital assets. Under the present law many sales of farms, mineral properties, and other capital assets have been prevented by the fact that gains and profits earned over a series of years are under the present law taxed as a lump sum and the amount of surtax excessively enhanced thereby. In order to permit such transactions to take place without fear of prohibitive tax, section 206 provides that only 40 percent of the net gain derived from the sale or other disposition of capital assets shall be taken into account in determining the net income upon which the income tax is imposed. This automatically reduces the rate of taxes applicable to such income by 60 percent. The maximum rate (normal and surtax) upon ordinary income after January 1, 1922, will be 40 percent, and the maximum rate applicable to capital net gain will be 16 percent. The House bill placed a similar limitation upon both capital gains and losses, but this limitation was not applicable to corporations nor to certain classes of taxpayers having net income less than $29,000. The Senate provision would permit a taxpayer to deduct the entire loss sustained in a capital transaction and is applicable to all classes of taxpayers. In Great Britain capital gain or loss is ignored or eliminated in computing the net income.

> Section 206 takes an intermediate position between the extreme views embodied, respectively, in the present American and British laws.

The Bill as agreed upon in conference was as follows:

> (B) In the case of any taxpayer (other than a corporation) who for any taxable year derives a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this Title, a tax determined as follows:
>
> A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per centum of the capital net gain; but if the taxpayer elects to be taxed under this section the total tax shall in no such case be less than 12½ per centum of the total net income. The total tax thus determined shall be computed, collected and paid in the same manner, at the same time and subject to the same provisions of law, including penalties, as other taxes under this title.

The Conference Report was as follows (H. Conference Rep. No. 486, 67th Cong., 1st Sess., p. 20):

> The House bill limited the tax to 12½ percent upon capital net gain and similarly limited the deduction allowance for capital net loss in the case of any taxpayer (other than a corporation) whose ordinary net income and capital net gain together exceed $29,000. Senate amendment 115 changes the House method of limiting the tax upon capital net gain, eliminates all reference to capital net loss, and makes this provision applicable to

all taxpayers (including corporations) who for any taxable year derive a capital net gain. The House recedes with an amendment providing that in the case of any taxpayer (other than a corporation) who for any year derives a capital net gain there shall (at the election of the taxpayer) be collected, in lieu of the taxes imposed by sections 210 and 211, a tax consisting of the sum of (1) a partial tax computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and (2) 12½ percent of the capital net gain; but if the taxpayer elects to be taxed under this section, the total tax shall in no such case be less than 12½ percent of the total net income.

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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 7

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

WILLIAM ALBERT HARBISON

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and opinion of the Board of Tax Appeals (R. 12–18) are reported in 26 B.T.A. 896. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 25) is reported in 68 F. (2d) 1004.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 15, 1934 (R. 25). A petition for a writ of certiorari was filed on March 23, 1934,

and was granted April 30, 1934. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Where the taxpayer elects to be taxed under Section 101 (a) of the Revenue Act of 1928, does the basis for computing the 15% deduction allowable for charitable contributions under Section 23 (n) of the Act include capital net gains, or is it limited to ordinary net income only?

STATEMENT

This case involves a deficiency in Federal income tax for the year 1928 in the amount of $930.56. (R. 18.)

The facts as stipulated (R. 11–12) and as found by the Board of Tax Appeals (R. 13–15) may be summarized as follows:

The taxpayer is a resident of White Plains, New York, and during the year 1928 had an "ordinary net income" of $66,634.87, as defined by Section 101 (c) of the Revenue Act of 1928, but without any allowance of a deduction for contributions as provided by Section 23 (n) of the Act.

During the taxable year 1928 the taxpayer had a "capital net gain" of $45,013.52 (R. 6, 17), as defined by Section 101 (c) of the Revenue Act of 1928, and elected to have this capital net gain taxed

under the capital net gain provisions of Section 101 (a) of the Act. (R. 15.)

The total amount of charitable contributions made during the taxable year 1928 by the taxpayer to organizations within the provisions of Section 23 (n) of the Revenue Act of 1928 was $27,996.83. (R. 15.)

The taxpayer claimed as a deduction for charitable contributions in his tax return so filed the sum of $16,747.26, being 15% of the sum of his "ordinary net income" and his "capital net gain."

The Commissioner of Internal Revenue in his amended answer (R. 10) took the position that the contribution deductions should be limited to $9,996.23, or 15% of the "ordinary net income", excluding "capital net gain." The Board of Tax Appeals sustained the Commissioner (R. 17–18) and determined a deficiency of $930.56 (R. 18). The Circuit Court of Appeals for the Second Circuit reversed (R. 24), on the authority of *Bliss* v. *Commissioner,* 68 F. (2d) 890 (C.C.A. 2d). Judge Learned Hand dissented.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In allowing the taxpayer, for the year 1928, to deduct charitable contributions under Section 23 (n) of the Revenue Act of 1928 to the extent of 15% of the sum of his ordinary net income plus his capital net gain.

2. In reversing the Board of Tax Appeals.

ARGUMENT

The issue here presented is identical with that presented in *Helvering* v. *Susan Dwight Bliss,* No. 6, present term. For the reasons set forth in the Government's brief in that case, it is respectfully submitted that the decision below should be reversed.

J. CRAWFORD BRIGGS,
Solicitor General.
FRANK J. WIDEMAN,
Assistant Attorney General.
JAMES W. MORRIS,
J. P. JACKSON,
Special Assistants to the Attorney General.

SEPTEMBER 1934.

U. S. GOVERNMENT PRINTING OFFICE: 1934

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*

vs.

SUSAN DWIGHT BLISS

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

JAMES McKINLEY ROSE,
Counsel for Respondent.

R. L. VON BERNUTH,
J. F. BOYER,
Of Counsel.

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IN THE

SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1933.

No. 887

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,
vs.
SUSAN DWIGHT BLISS.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

This brief is in opposition to the petition of the Commissioner of Internal Revenue for a Writ of Certiorari to review the judgment of the Circuit Court of Appeals for the Second Circuit (R. 31) entered in the above cause on January 15, 1934, which reversed a decision of the Board of Tax Appeals.

Opinions Below.

The Findings of Fact (R. 16, 17) and opinion (R. 18-20) of the Board of Tax Appeals, promulgated December 2, 1932, are reported in 27 B. T. A. 205. The opinions of the Circuit Court of Appeals for the Second Circuit (R. 26-31) is reported in 68 Fed. 2nd 890.

Question Presented.

The facts involved in the case are sufficiently stated by the Solicitor General on pages 2 and 3 of his petition. One question only was presented to the Court below for its

opinion, the decision on which is the subject of this petition for review:

Does a taxpayer's "net income", upon which is based the 15% limitation of deductions for charitable contributions allowed by Section 23-n of the Revenue Act of 1928, include capital net gains if the taxpayer has elected to be taxed thereon under the provisions of Section 101 of said Act.

Statutes Involved.

The pertinent provisions of the Revenue Act of 1928 are set forth in the Appendix, infra, pages 5-8. These include Sections 21 and 22 of that Act, which are omitted from the petition and appendix thereto.

ARGUMENT.

POINT I.

There is no necessity for a review by this Court of the question here presented since the statutes involved have been correctly interpreted by the Courts and the Board of Tax Appeals.

Gross income as defined by Section 22 of the Revenue Act of 1928 includes capital gains. Under Section 21 of that Act net income is defined as gross income less certain deductions specified in Section 23. One of these deductions is for charitable contributions to the extent of 15% of the net income of the taxpayer computed without allowance for the deduction of charitable contributions. These three sections determine the net income of the taxpayer for all purposes of the Act.

Nothing in the 1928 Act or in Section 101 thereof alters the definition of "net income" for any purpose. When the net income has been determined in accordance with Sections 21, 22 and 23 of the Act, the taxpayer, by Section 101 of the Act, is given an option of having that part of the net income

which is derived from capital net gain taxed at a flat rate of 12½%, and for this purpose only Section 101 directs a separation of "net income" into "ordinary net income" and "capital net gain".

This is the construction placed upon these sections by the four courts which have passed upon the question,* including the Circuit Courts of Appeals in the First and Second Circuits; this is the construction adopted and followed by the Commissioner of Internal Revenue under the provisions of the 1921, 1924, 1926 and 1928 Acts prior to the decision of the Board of Tax Appeals in 1931 in *Elkins* v. *Commissioner,* 24 B. T. A. 572, involving capital net loss; and this is the construction followed by the Board of Tax Appeals since its decision in 1933, in *Straus* v. *Commissioner,* 27 B. T. A. 1116, in which the Board, acting as a whole, overruled the prior decisions of individual members of the board in the case at bar, in *Colgate* v. *Commissioner,*** 27 B. T. A. 506 and in *Harbison* v. *Commissioner,*** 26 B. T. A. 896, each of which involved capital net gains.

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* In addition to the case at bar and *Helvering* v. *Harbison,* No. 888, October Term 1933, and *Helvering* v. *Colgate,* No. 889, October Term 1933, in which petitions for writs of certiorari to the Circuit Court of Appeals for the Second Circuit have been filed simultaneously, the following court decisions have been rendered or are pending:

White v. *Atkins,* C. C. A. 1st, decided March 14, 1934, affirming *Atkins* v. *White,* D. Mass. 3 Fed. Supp. 694;

Blow v. *U. S.,* (N. D. Ill.) 5 Fed. Supp. 737, pending before argument on appeal to the Circuit Court of Appeals for the Seventh Circuit;

Straus v. *Commissioner,* 27 BTA 1116, pending after argument on petition for review in the Court of Appeals of the District of Columbia;

Robinette v. *Commissioner,* 27 BTA 1426, pending after argument on petition for review in the Circuit Court of Appeals for the Third Circuit;

Igleheart v. *Commissioner,* 27 BTA 1426, pending after argument on petition for review in the Circuit Court of Appeals for the Seventh Circuit.

** *Colgate* v. *Commissioner.* Decision of BTA reversed, January 8, 1934, by the Circuit Court of Appeals, Second Circuit, on the decision in *Bliss* v. *Commissioner,* not yet reported.

Harbison v. *Commissioner.* Decision of BTA reversed, January 8, 1934, by the Circuit Court of Appeals, Second Circuit, 68 Fed. 2nd 1004.

The majority opinion of the Circuit Court of Appeals in the case at bar (R., 26-29) contains a history of the Revenue Acts and the decisions thereunder and the reasoning applicable to the construction of the statute.

At present there is no decision involving capital net gain in conflict with that in the case at bar. The Commissioner of Internal Revenue alone refuses to accept the construction adopted by the courts and the Board of Tax Appeals. The Commissioner argues that the decision of the Circuit Court of Appeals for the Fifth Circuit in *Westfeldt* v. *Commissioner*, 63 Fed. 2d 882, is contrary in principle to the cases above set forth. That case, however, has no application to that at bar as the question there involved was the treatment of income derived from a partnership (Section 207 (b) Revenue Act of 1924), and the effect of the decision was merely to place such income on a parity with other income of the taxpayer with respect to capital net loss for purposes of computing the tax.

We submit that the reading of Sections 21 and 22 together with Sections 23 and 101 (a) and (c) 1, 3 and 7, will demonstrate that the correct interpretation has been placed upon the statute by the Courts below, and that the decision of this case does not involve "an important question of Federal law which has not been, but should be, settled by this court".

POINT II.

The petition for writ of certiorari should be denied.

Respectfully submitted,

JAMES McKINLEY ROSE,
Counsel for Respondent.

R. L. von Bernuth,
J. F. Boyer,
Of Counsel.

APPENDIX.

REVENUE ACT OF 1928, Chap. 852, 45 STAT. 797, 799, 811.

Sec. 21. NET INCOME. "Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

Sec. 22. GROSS INCOME. (a) *General Definition*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * * *

Sec. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:

* * * * * *

(n) *Charitable and Other Contributions.* In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

* * * * * *

(2) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

* * * * * *

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if

verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

Sec. 101. CAPITAL NET GAINS AND LOSSES.

(a) *Tax in Case of Capital Net Gain.* In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) *Tax in Case of Capital Net Loss.* In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) *Definitions.* For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net

income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. For the purposes of this definition—

> (A) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged.

(B) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 113, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(C) In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain is recognized to the distributee under the provisions of section 112 (g) of this title or under the provisions of section 203 (c) of the Revenue Act of 1924 or 1926, there shall be included the period for which he held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution.

(d) *Collection and Payment of Tax.* The total tax determined under subsection (a) or (b) shall be collected and paid in the same manner, at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

FILE COPY

APR 12
CHARLES ELMORE

No. [redacted] 7

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1933.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

WILLIAM ALBERT HARBISON.

BRIEF FOR THE RESPONDENT IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI.

JAMES E. MACCLOSKEY, JR.,
HUGH SATTERLEE,
Counsel for the Respondent.

I

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1933.

No. 888.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,
v.
WILLIAM ALBERT HARBISON.

BRIEF FOR THE RESPONDENT IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals (R. 30–36) is reported in 26 B. T. A. 896. The opinion of the Circuit Court of Appeals for the Second Circuit is reported in 68 Fed. (2d) 1004.

QUESTION PRESENTED.

Where the taxpayer elects to be taxed under Section 101 (a) of the Revenue Act of 1928, does "net income," by which the maximum 15 per cent. deduction from gross income allowable for contributions under Section 23 (n) of the Revenue Act of 1928 is measured, include capital net gain?

STATUTES AND REGULATIONS INVOLVED.

The applicable provisions of the statutes and regulations involved are set forth in the appendix hereto.

STATEMENT.

The facts as stipulated and found are as follows (R. 22–24, 26–30, 43, 44):

The taxpayer during the taxable year 1928 had net income of $111,648.39, as defined by Section 21 of the Revenue Act of 1928, but before any allowance of a deduction for charitable contributions as provided for by Section 23 (n). Of such statutory net income $66,634.87 was ordinary net income and $45,013.52 was capital net gain, as defined by Section 101 (c). The taxpayer elected to have his capital net gain taxed under the capital net gain provisions in Section 101.

During the taxable year he made charitable contributions within the scope of Section 23 (n) amounting to $27,996.83. He claimed in his tax return, as a deduction for such charitable contributions, the sum of $16,747.26, which was equal to 15 per cent. of his statutory net income of $111,648.39 as computed without the benefit of the deduction for charitable contributions. The Board of Tax Appeals decided that his deduction for charitable contributions should be limited to 15 per cent., not of his net income, but of his ordinary net income. The Circuit Court of Appeals reversed the Board and held that the taxpayer's computation was correct.

ARGUMENT.

1. The statute provides (Section 23 (n)) that the 15 per cent. limitation shall be based on "net income." The Government's present contention is that, where the taxpayer elects to have his capital net gain subjected to tax under Section 101 of the statute, the 15 per cent. limitation shall be based on ordinary net income instead of net income, although it is not disputed that capital net gain is included in net income. The result of the Government's contention is a denial of the proposition that the whole is equal to the sum of its parts, because, according to the Government, the sum of capital net gain plus ordinary net income is not equal to, but exceeds net income. The fallacy in the Government's contention lies in attempting

to apply Section 101 before the net income, upon which the deduction for contributions is based, is determined under Sections 21, 22 and 23, and in failing to recognize that Section 101 provides only for the calculation of the tax and for the classification of net income, and not at all for the determination of net income. The Government confuses the two operations of the computation of net income and the computation of the tax.

The Government's excuse for its application for a writ of certiorari is that the Board of Tax Appeals rendered three or four erroneous decisions which it promptly overruled when its error was pointed out to it.

For a number of years the revenue acts have allowed a deduction from gross income for charitable contributions limited to 15 per cent. of net income before deducting such charitable contributions In the Revenue Act of 1921 provision was made for an optional tax on net gain derived from the sale of capital assets held over two years, and for the purpose of computation of such tax net income was divided into capital net gain and ordinary net income. In the Revenue Act of 1924 the provision was extended to apply to capital net losses.

Until 1932 the construction of the statute by the Treasury Department was consistent that both capital net gain and capital net loss, being part of net income, should be taken into account in determining the maximum deduction for charitable contributions. The Commissioner's position with respect to capital gains was first set forth in a telegram dated February 6, 1923 (C. C. H. Federal Income Tax Service 1924, ¶2033), and his position with respect to capital losses in I. T. 2104 (III-2 C. B. 152), promulgated in 1924.

On November 3, 1931, the Board of Tax Appeals held in *Elkins* v. *Commissioner*, 24 B. T. A. 572, that a capital net loss should be disregarded in the computation of charitable gifts. On January 27, 1932, in Mim. 3931 (XI-1 C. B. 33), the Commissioner stated:

> "The Board's decision is contrary to the position which the Bureau has consistently followed as announced in

I. T. 2104 (C. B. III-2, 152). The decision will be appealed, and in the audit of returns involving capital losses, the Bureau will continue to follow I. T. 2104."

Shortly thereafter the Board of Tax Appeals handed down decisions in the Bliss, Colgate and Harbison cases, now before this Court on applications for writs of certiorari, holding that capital net gains should be disregarded in the computation of the deduction for charitable contributions. The Commissioner thereupon embraced the benefits of these decisions and has since adopted a construction of the statute directly contrary to his practice uniformly followed since the enactment of the Revenue Acts of 1921 and 1924, the provisions of which were substantially reenacted in the Revenue Acts of 1926, 1928, and 1932.

On April 6, 1933, the Board of Tax Appeals in *Straus* v. *Commissioner*, 27 B. T. A. 1116, reversed its position in these cases, and held in accordance with the original construction of the statute by the Commissioner. Subsequently the Board rendered further decisions with respect to the inclusion of net gains in the computation of the deduction for charitable contributions, all in accordance with its decision in the *Straus* case. (*Robinette* v. *Commissioner*, 27 B. T. A. 1426; *Woodward* v. *Commissioner*, 27 B. T. A. 1426; *Igleheart* v. *Commissioner*, 27 B. T. A. 1426.) The District Court of the United States for the District of Massachusetts in *Atkins* v. *White*, 3 Fed. Supp. 694, and the District Court of the United States for the Northern District of Illinois, Eastern Division, in *Blow and Chatfield-Taylor, as Administrators*, v. *United States*, 5 Fed. Supp. 737, have held in accordance with the original position of the Commissioner and the present position of the Board of Tax Appeals. In addition to the Circuit Court of Appeals for the Second Circuit, which has reversed the Board's erroneous decisions in the *Bliss*, *Colgate* and *Harbison* cases, the Circuit Court of Appeals for the First Circuit has adopted the same position in affirming *Atkins* v. *White*, *supra*, —— Fed. 2d —— (C. C. H. Federal Income Tax Service 1934, ¶ 9185).

On the question now presented to this Court with respect to

the inclusion of capital net gain in net income for the purpose of computing the deduction for charitable contributions, there is, so far as we know, absolute unanimity of authority in the Board of Tax Appeals and in the United States courts, supported not only by the logical and reasonable construction of the statute, but by the construction and practice consistently and uniformly adopted by the Treasury Department from 1921 to 1932.

2. With respect to the question of accounting for capital net losses in the determination of net income, *Elkins* v. *Commissioner*, *supra*, 24 B. T. A. 572, and *Livingood* v. *Commissioner*, 25 B. T. A. 585, were decided before the reversal by the board of its erroneous position with respect to capital net gains and stand unaffected only because decided favorably to the taxpayers and because the Commissioner changed his original position. If, as is probably the case, capital net losses as well as capital net gains should be included in net income for the purpose of computing the deduction for charitable contributions, there is no occasion for this Court to pass separately on the question of capital net losses, but, if a difference exists in the case of capital net losses, that question is not now before this Court and can not conceivably be decided by this Court upon any review of a case involving only capital net gains.

3. A decision of this Court scarcely seems necessary to settle the confusion now existing in the administration of the provisions involved, such confusion being entirely due to the unwarranted abandonment by the Treasury Department of its original position. On the basis of the unanimous authority now existing, the Treasury Department can and should reinstate its original construction and practice of so many years standing. There is no conflict of authority which requires resolution by this Court.

4. The reference in the Government's petition in the *Bliss* case to *Westfeld* v. *Commissioner*, 63 Fed. (2d) 882, shows the weakness of its position. That decision was concerned with

an entirely unrelated provision of the statute, providing that income from a partnership subject to the rates in effect for the most recent calendar year should be added to the other income of the taxpayer subject to such rates, and it was held that the "other income" to which the partnership income was to be added was the ordinary income, excluding capital items taxable at a different rate. There was no question of "net income," which is specifically defined by the statute. An examination of the opinion in the Westfeldt case indicates how far the principle there enunciated is from conflicting with the decisions here in question.

CONCLUSION.

The decision of the Court below is correct and in accord with all existing decisions. No sufficient reason appears for its review by this Court. The petition should be denied.

J. E. MacCloskey, Jr.,
Hugh Satterlee,
Counsel for the Respondent.

April 12, 1934.

APPENDIX.

(Revenue Act of 1928, c. 852, 45 Stat. 791.)

TITLE I—INCOME TAX

PART II—COMPUTATION OF NET INCOME

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) **General definition.**—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(Here follows a list of allowable deductions, including expenses, interest, taxes, losses, bad debts, etc.)

(n) **Charitable and other contributions.**—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * *

(2) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholders or individual; * * *

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. * * *

SUBTITLE C—SUPPLEMENTAL PROVISIONS

SUPPLEMENT A—RATES OF TAX

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) **Tax in case of capital net gain.**—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) **Tax in case of capital net loss.**—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) **Definitions.**—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the

capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.
* * *

(Treasury Department Regulations 74, promulgated under the Revenue Act of 1928.)

ART. 501. **Definition and illustration of capital net gain.** —Section 101, which applies to sales and exchanges of capital assets consummated after December 31, 1921, provides that any taxpayer other than a corporation may, if he so desires, state separately in his return his net gain on sales or exchanges of capital assets, and pay on such capital net gain (as defined and limited in the section) a tax of 12½ per cent of the capital net gain in lieu of the tax he would otherwise pay on such income under sections 11, 12, 102, and 211. The tax upon his net income from other sources, termed "ordinary net income," is to be computed at the rates and in the manner provided in sections 11, 12, 102, and 211. The total tax will be the sum of the tax upon the ordinary net income plus 12½ per cent of the capital net gain. * * *

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CHARLES ELMORE C
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IN THE

Supreme Court of the United States

OCTOBER TERM—1934.

No. 6

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

against

SUSAN DWIGHT BLISS

BRIEF FOR RESPONDENT.

JAMES McKINLEY ROSE,
Counsel for Respondent.

R. L. VON BERNUTH,
MORRELL S. LOCKHART,
JOHN F. BOYER,
Of Counsel.

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IN THE

Supreme Court of the United States,

OCTOBER TERM 1934.

No. 6.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

against

SUSAN DWIGHT BLISS

BRIEF FOR RESPONDENT.

This is an appeal on writ of certiorari granted April 30, 1934 (R. 32) from a judgment of the Circuit Court of Appeals for the Second Circuit (R. 31) which reversed an order of the United States Board of Tax Appeals (R. 20) redetermining deficiencies in respondent's income taxes for the years 1928 and 1929.

Opinions Below.

The findings of fact (R. 16, 17) and opinion of the Board of Tax Appeals (R. 18-20) promulgated December 2, 1932 are reported in 27 B. T. A. 205. The opinions of the Circuit Court of Appeals for the Second Circuit (R. 26-31) are reported in 68 Fed. 2d 890. The order granting certiorari (R. 32) is reported in 78 L. Ed. 863.

Statement of Facts.

The proceedings before the Board of Tax Appeals were begun by petitions (R. 2-6; 9-12) to review income tax deficiencies, for the years 1928 and 1929, in the amounts of $1909.31 and $1009.41, respectively, assessed against respondent by the Commissioner of Internal Revenue, as set forth in deficiency letters of the Commissioner, copies of which are annexed to the petitions.

The issues litigated before the Board of Tax Appeals were raised as to the 1928 case by an amended petition (R. 6-7) and an amended answer to the amended petition (R. 7-8) and as to the 1929 case by the petition (R. 9-12) and the amended answer thereto (R. 12-13).

In the amended answers (paragraphs 4 and 6, respectively) before the Board of Tax Appeals, the Commissioner for the first time questioned the amount of charitable contributions claimed as a deduction by respondent, and alleged that the deductions allowed by him for charitable contributions upon the audits of respondent's tax returns for said years were excessive (R. 8, 12, 13).

Prior to the hearing before the Board of Tax Appeals the respondent and the Commissioner entered into stipulations in both cases (1928: R. 13-14; 1929: R. 15) disposing of all questions except the one now before this court and agreeing upon the facts relevant to this question. The stipulations are summarized in the government's statement of facts. At the hearing the cases were consolidated and have been treated as one case throughout the subsequent litigation.

Questions Presented.

One question only was presented to the court below for its opinion and one question only is involved on this appeal:

May the taxpayer deduct charitable contributions up to 15% of net income (as defined by Section 21 of the Revenue Act of 1928), or only up to 15% of net income

less capital gains, if the taxpayer has elected to be taxed on capital net gains under the provisions of Section 101 of said act.

The respondent contends that under the provisions of Sections 21 and 23-n of said act the taxpayer is entitled to deduct charitable contributions up to 15% of total net income irrespective of her election as to the taxation of her capital net gains under Section 101 of said Act.

The Commissioner, on the other hand, contends that if the taxpayer elects to be taxed on capital net gain at the flat rate provided by Section 101, deductions for charitable contributions should be limited to 15% of "ordinary net income", which is computed after excluding from net income (and hence from gross income from which such net income is determined) all taxable net capital gain.

The difference in respondent's income tax liability for the years 1928 and 1929 under these two contentions is shown by the following tabulation:

As to the year 1928	*Respondent's Computation*	*Commissioner's Computation*
(a) Net Income as defined by Section 21 without deducting charitable contributions allowed by Section 23-n	$482,035.59	$482,035.59
(b) Capital net gain as computed under Section 101(c) (5)		211,544.82
(c) "Ordinary net income" as computed under Section 101(c) (7) without allowance for charitable contributions		270,490.77
(d) Limit of deduction for charitable contributions allowed by Section 23-n		
Respondent's contention (15% of (a))	72,305.34	
Commissioner's contention (15% of (c))		40,573.62
(e) Total contributions made by Respondent	43,995.92	43,995.92
(f) Deficiency of taxable income claimed by Commissioner		3,422.30

As to the year 1929	*Respondent's Computation*	*Commissioner's Computation*
(a) Net income, as defined by Section 21, without deducting charitable contributions allowed by Section 23-n	$547,514.14	$547,514.14
(b) Capital net gain as computed under Section 101(c) (5)		299,942.31
(c) "Ordinary net income" as computed under Section 101(c) (7) without allowance for charitable contributions		247,571.83
(d) Limit of deduction for charitable contributions allowed by Section 23-n		
Respondent's contention (15% of (a))	82,127.12	
Commissioner's contention (15% of (c))		37,135.77
(e) Total contributions made by Respondent	39,088.46	39,088.46
(f) Deficiency of taxable income claimed by Commissioner		1,952.69

Statutes Involved.

The pertinent provisions of the Revenue Act of 1928, under which this case must be decided, are set forth in the Appendix, *infra,* pages 21-27. The title headings as they appear in the Statute have been retained in the Appendix, as they are necessary for an understanding of the question here involved.

Summary of Argument.

The controlling provisions of the Revenue Act of 1928 are to be found in Sections 21, 22 and 23 which define for all purposes of the Act gross income, net income and deductions from gross income, including deductions for charitable contributions. Section 23(n) limits the deduction for charitable contributions to 15% of taxpayer's net income, which is defined by Section 21 to be gross income, computed under Section 22, including all capital gains, less the deductions, allowed by Section 23. This is the only pro-

vision in the Act concerning deductions for charitable contributions and must govern every case in which such deduction is taken. Unless these sections are modified by some provision of Section 101 or the other sections dealing with capital gains and losses, capital gains must be included in determining the amount of net income from which the 15% limitation for charitable contributions is determined.

Section 101 does not modify the provisions of Sections 21, 22 and 23 determining the amount of taxpayer's net income and allowable deductions. The Revenue Act of 1928 is divided by title headings which are a guide to the proper construction of its sections. Subtitle B—Part I and the corresponding Supplement A of Subtitle C, dealing with capital gain and losses, are concerned solely with rates of tax. Subtitle B—Part II and the corresponding Supplement B of Subtitle C are concerned with the computation of net income. Section 101 is contained in Supplement A (rates of tax) whereas Sections 21, 22 and 23 are contained in Subtitle B—Part II (computation of net income). Reference is made to the Appendix hereto (*infra*, pp. 21-27), which shows that the Act is divided in such manner as to indicate the respective application of the various sections.

The construction placed upon the Act by respondent is required by the wording of the statute. It has been sustained by every court which has passed on the point and is supported by the evident intention of Congress as found in the reports of Committees, the interpretation of judges and the repeated passage of pertinent provisions of the Act in identical language after administrative interpretation thereof in accordance with respondent's contention.

The fact that Congress did not make clear an intention to exclude capital net gains from the base upon which the limitation for contributions is computed when it might very easily have done so by a simple express provision, is strong evidence that Congress did not intend that the charitable contribution provisions of the Act should be modified by the capital gain provisions. Both provisions were included for the purpose of relieving the taxpayer of excessive tax

burdens and encouraging him, on the one hand, to make contributions, and on the other, to realize his capital gains. It is not likely that Congress intended to allow the taxpayer the advantage of one such provision only at the cost of losing the advantage of the other.

ARGUMENT.

POINT I.

Respondent was entitled to deduct charitable contributions to the extent of fifteen percent of total net income including capital net gains.

The essential conflict between respondent's position and that of the Commissioner lies in the interpretation of Section 23-n, which reads:

> "Section 23 (26 U. S. C. A. Section 2023) In computing net income there shall be allowed as deductions:
> * * * * * * *
> (n) *Charitable and other contributions:* In the case of an individual, contributions or gifts made within the taxable year * * * to an amount which in all the above cases combined does not exceed 15 percentum of the taxpayer's net income as computed without the benefit of this sub-section. * * *"

This is the only provision in the Revenue Act of 1928 dealing specifically with deductions for charitable contributions and must govern all cases in which such deductions are claimed. A proper interpretation of Section 23(n) requires that it be read with Sections 21 and 22 of the same Act.

Section 21 defines net income for all purposes of the Act, as follows—

> "Section 21 (26 U. S. C. A., Section 2021) 'Net income' means the gross income computed under Section 22, less the deductions allowed by Section 23."

Section 22 defines "gross income" as follows:

> "Section 22 (26 U. S. C. A., Section 2022) 'Gross income' includes gains, profits, * * * and income derived from any source whatever."

Capital net gains are a part of gross income and, except as they may be reduced by the deductions allowed by Section 23, are also a part of net income. By Section 23-n, read in connection with Sections 21 and 22, charitable contributions are, therefore, a direct deduction from gross income including capital net gain, the amount of such deduction being limited only by the provision that it shall not exceed 15% of the taxpayer's net income, which also includes capital net gain.

The above sections are all contained under Sub-title B, Part II, entitled "Computation of Net Income." There are no provisions in Sub-title C which is supplementary to the provisions of Sub-title B, which limit, or modify in any way, the applicability of the above definitions to the determination of respondent's net income.

Section 101 is contained in Sub-title C, Supplement A—entitled "Rates of Tax [Supplementary to Sub-title B, Part I]", and has no application to the computation of gross or net income or deductions from gross income, contained in Sub-title B, Part II. It affects solely the amount and rate of tax on such part of net income, already computed under the prior sections of the act, as is allocable to capital net gains and losses. It concerns the computation of a tax on a specific kind of net income, not a computation of net income subject to tax.

This appears from the headings under which the Act is arranged. Sub-title B, Part I is entitled "Rates of Tax". Sec. 11, "Normal Tax on Individuals", and Sec. 12, "Surtax on Individuals", in Part I, relate to the normal and surtaxes on individuals, and in Sec. 12 appears the following:

> "(c) Capital Net Gains and Losses.—For rate and computation of tax in lieu of normal and surtax in case of net incomes of not less than $30,000, ap-

> proximately, or in case of net incomes, excluding items of capital gain, capital loss and capital deductions, of not less than $30,000, approximately, see section 101."

Subtitle B, Part II is entitled "Computation of Net Income", and contains Sections 21, 22 and 23. Part II says nothing as to the exclusion of capital gains or losses in the computation of net income.

Subtitle B also contains Parts III, IV and V which respectively deal with "Credits against Tax", "Accounting Periods and Methods of Accounting" and "Returns and Payment of Tax".

Subtitle C bears the general heading "Supplemental Provisions" and contains subdivisions headed, respectively, Supplements A, B, C and D, which in each instance are stated to be supplemental to Parts I, II, III and V, respectively, of Subtitle B. Supplement A is entitled "Rates of Tax" (Supplementary to Subtitle B, Part I, the rate of tax part of Subtitle B), and it is under this supplement that Section 101, relating to the rate of tax on capital net gains and losses is placed. Supplement B is entitled "Computation of Net Income" (Supplementary to Subtitle B, Part II), and its provisions deal exclusively with the method of arriving at gain or loss, including capital gain or loss, and say nothing about segregating capital net gain from the computation of net income. It is apparent, therefore, that such segregation is by the form of the statute made for the purpose of applying a different rate of tax to such capital gains, as expressly provided for by subdivision c of Section 12, cannot affect the deductions to which the taxpayer is entitled under Section 23 of Subtitle B, Part II, relating to the computation of net income.

The government contends, in its brief, that if the taxpayer elects to be taxed under Section 101 (a) the words "ordinary net income" (as defined by Section 101 (c)—(7)) must by implication be substituted for the words "net income" in Section 23 (n), so that charitable contributions will be limited to fifteen percent of "ordinary net

income'' instead of fifteen percent of net income. In support of this contention the government argues that Section 101 contains specific provisions dealing with taxpayer's allowable deductions in such cases which supersede the general provisions of Sections 21, 22 and 23. The government also reads into Section 101 an intention, not apparent from the wording thereof, that capital gains shall be segregated from ''ordinary net income'' for all purposes of the Act. The fallacy of this contention is apparent when one considers the scope of Section 101 as defined by the headings under which it appears as above discussed. In its brief the government omits these headings and treats the Act as though there were no distinction between the provision for rates of taxation and those for the computation of income. Appendix A to the government's brief also omits, except in respect to Sections 21, 22 and 23, the Subtitle headings applicable to the sections. This omission is indicative of the error into which the government has fallen. The distinction is inherent in the Act and a recognition of it is essential to an interpretation of the statute. The entire force of the government's argument is spent by reason of its ignoring the title headings. The provisions of Supplement A of Subtitle C, which contains Section 101 are supplementary to the provisions of Subtitle B—Part I and purport to deal only with the rate of tax on net income where capital net gains are included therein. To read into this section an intention to alter the meaning of the prior provisions of Subtitle B—Part II defining gross income, net income, and deductions from net income is to ignore the express wording of the statute. This is further borne out by the fact that the provisions of Supplement B of Subtitle C, Supplementary to Subtitle B—Part II, relating to the computation of net income, contain no provisions whatsoever altering the definitions of net income and gross income, or changing the allowable deductions.

Section 101 gives the taxpayer an election to have his income derived from capital net gain taxed at a different rate from that applied to income derived from other sources. The taxpayer may divide his taxable *net income*

into two parts. The first represents all such income from sources other than capital net gain and on this part he pays a tax computed at the usual rates provided under the earlier sections of the Act. For convenience of nomenclature this part is called "ordinary net income". On the balance of his net income, consisting solely of capital net gain, the taxpayer pays a tax at a flat rate of 12½%. The words "ordinary net income" are used solely to differentiate income derived from other sources of revenue than capital net gain for the purpose of fixing a tax thereon.

As an additional argument in support of the construction which it seeks to place on Section 101, the government states at page 16 of its brief: "Sections 11 and 12 of the 1928 Act (infra, p. 27) levy a normal tax and a surtax on the taxpayer's 'net income', but where the capital gain provisions are applied 'net income' as used in those sections is taken to mean 'ordinary net income' ". This statement is erroneous. Where the capital gain provisions are applied, Sections 11 and 12 are superseded by Section 101 (a), which directs that

> "there shall, at the election of the taxpayer, be levied, collected and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain."

There is no implied modification of the meaning of "net income" as used in Sections 11 and 12 but an express provision dividing such net income into its component parts and providing new rates of tax therefor.

There is nothing in Section 101, supplementing Subtitle B, Part I, which either expressly or by implication changes the definitions of net income, gross income, or deductions from gross income contained in Sections 21, 22 and 23 under Subtitle B, Part II, nor is there anything to that

effect in the provisions of Sections 111 to 120 which do supplement Subtitle B—Part II.

Nor does Section 23-n, either expressly or by implication, limit deductions for charitable contributions to 15% of "ordinary net income". On the contrary it specifically authorizes such deductions up to 15% of "net income".

The contention of the respondent as to the proper interpretation of the law has been upheld by every court which has passed on the question, including the final determination of the full membership of the Board of Tax Appeals.

> *White* v. *Atkins*, C. C. A. 1st., 69 Fed. 2nd 960
> Affirming *Atkins* v. *White*, 3 Fed. Supp. 694;
> *Blow* v. *United States*, N. D. Ill., 5 Fed. Supp. 737;
> *Straus* v. *Commissioner*, 27 B. T. A. 1116.

This was also the view of the majority of the Circuit Court of Appeals for the Second Circuit in the case below.

> *Bliss* v. *Commissioner*, 68 Fed. 2nd, 890 (R. 26-29).

In this case, Judge Swan, who rendered the majority opinion, said at page 892:

> "There is nothing in section 101 which expressly indicates that the taxpayer was intended to lose any part of the deductions allowed by section 23 when his tax is determined according to the rates provided in section 101. Paragraphs (a) and (b) deal with computation of the tax rather than with computation of taxable income; the usual rates are applied, 'as if this section had not been enacted', to that part of the taxable income called 'ordinary net income' and the special 12½ percent rate to 'capital net gain' or 'capital net loss.' Paragraph (c) defines the terms used in the earlier paragraphs. It does not indicate an intention to modify the definitions of 'net' and 'gross' income contained in sections 21 and 22 (26 U. S. C. A. §§ 2021, 2022), nor to change the deductions allowed by section 23 (26 U. S. C. A. § 2023). On the contrary, clauses (3) and (4) of section 101 indicate that they are to remain unchanged. They divide

> such deductions into 'capital deductions' and 'ordinary deductions.' The latter mean 'the deductions allowed by section 23 other than capital losses and capital deductions.' Clause (5) defining 'capital net gain' makes it necessary to determine whether 'ordinary deductions' exceed 'gross income computed without including capital gains.' We do not understand this to be a direction that in computing 'ordinary deductions' gross income is to be decreased by the exclusion of capital gains. It means to us that ordinary deductions are to be figured in the ordinary way and then compared with 'gross income computed without including capital gain' to see if they exceed it. If this be the correct construction, there is harmony between clause (5) and clause (7), and 'net income' computed in accordance with sections 21, 22, and 23 is composed of two parts, 'ordinary net income' and 'capital net gain', to which respectively the appropriate rates may be applied as provided in paragraph (a)".

In *Straus* v. *Commissioner*, 27 B. T. A. 1116, (pending after argument on petition for review in the Court of Appeals, District of Columbia) the Board of Tax Appeals, reversing its previous decisions and holding that capital net gains should be included in computing the allowable deduction for charitable contributions, said concerning the construction of Section 101 at page 1121:

> "Apparently the Commissioner places his chief reliance upon the language of section 101 (c) (7), which is as follows:
>
> > '"Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.'
>
> This language does not mean that net income is to be *computed* after excluding certain items of a capital nature. It means that 'net income' is to be computed in the regular way and 'ordinary net income' is what remains of this 'net income' after the capital items have been excluded from it. This is clearly indicated by the punctuation used by Con-

gress. The phrase 'computed in accordance with the provisions of this title' is set off by commas and modifies 'net income'. Section 101 (c) (7) is not to be read as if one or both of the first two commas had been omitted, or as if it provided that ordinary net income means net income computed after excluding all items of a capital nature. 'This title' means Title I. Net income computed in accordance with Title I is obviously net income as defined in section 21 of Title I, i. e., gross income as defined in section 22 less the deductions allowed by section 23. There is in section 101 (c) (7) no further limitation on the deduction for contributions beyond that contained in section 23 (n). Since there is nothing to indicate that Congress had this subject in mind while framing this section, we should be slow to read the intent into the words used by Congress on an unrelated subject. We may not read this thought into the statute where the words used do not contain it. Note the difference in section 101 (c) (5), where Congress used the words 'gross income computed without including capital gains.'

'Capital net gain' means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

If Congress, in section 101 (c) (7) had used the words 'net income computed without including capital gain' the Commissioner would be supported in his contention. But it did not use these words or any of like import."

See also

White v. *Atkins*, 69 Fed. 2d, 960, at page 963.

The foregoing construction of Section 101 accords with the scheme of the Revenue Act of 1928 as expressed in other sections. Throughout the Act Congress has provided for the taxation of various portions of net income at special rates, exempting parts thereof entirely, depending upon the circumstances in the case of each individual taxpayer. Examples are to be found in Section 31, which provides for

the segregation of a portion of net income to be known as "earned income" to be taxed at a lower rate, and in Section 25, which provides for credits against net income, in computing normal tax, of dividends from domestic corporations and interest on certain United States obligations. Sections of this character in no way affect the amount of "net income" upon which the deduction of 15% for charitable contributions is based. Section 101 is only another instance in the Act where a specific portion of "net income" is taxed at a special rate and is not pertinent to the construction of Sections 21, 22 or 23 (n).

The government cites the case of *Westfeldt* v. *Commissioner*, 63 Fed. 2nd, 882, in support of its theory that segregation of capital net gains from "ordinary net income" is, under the provisions of Section 101, made complete for all purposes of the Act. That case is no authority for the theory, as the segregation there referred to was merely for the purpose of applying the proper rates of tax to the various classes of income involved. It should be noted that the statute applicable to that case (Section 207 (b), Revenue Act of 1924) specifically provided that the partnership income there in question should be added to "the other income of the taxpayer *subject to such rates*" (i. e., the ordinary rates for income during the year 1924). Neither the facts nor the language of the case is authority for the broad interpretation which the government seeks to place on Section 101.

The government cites and argues from the decision of the Board of Tax Appeals in *Elkins* vs. *The Commissioner*, 24 B. T. A. 572. We believe that the principles involved in this decision might be sustained upon considerations other than those involved in this case. The *Elkins* case involved capital net loss. Insofar as the principles governing capital net gain and capital net loss are the same, we believe the *Elkins* decision is unsound.

POINT II.

The construction of the Act by the Court below is in accordance with the Congressional intent.

The purpose of Section 101 has been stated by Mr. Justice Stone in *Burnet* v. *Harmel,* 287 U. S. 103, 106; 77 L. Ed. 199, 202 to be:

> "to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments and to remove the deterrent effect of these burdens on such conversions."

citing House Report, No. 350, Ways and Means Committee, 67th Congress, First Session, on the Revenue Bill of 1921, page 10.

Similarly, the purpose of Section 23-n was stated by Judge Swan in the majority opinion in the case below, 68 Fed. 2nd, 890, at page 891 (R. 27), as follows:

> "The provision permitting a deduction from gross income of charitable contributions to the extent of 15 percent of the net income computed without the benefit of this deduction was introduced into the income tax law by section 1201(2) of the Revenue Act of 1917 (40 Stat. 330). Its obvious purpose was to encourage gifts for charity, education, and science (Cong. Rec., September 7, 1917, p. 5728). It has been continued in substantially the same form in each successive revenue act."

A construction which permits the taxpayer to have his capital gains taxed at a flat rate only at the cost of decreasing the benefit of the deductions for charitable contributions allowed by Section 23 (n) is in direct contravention of the purposes of Section 101 and of Section 23-n so expressed.

It should be noted that had Congress intended the result sought by the Commissioner it could have achieved it simply and conclusively by providing affirmatively in Sub-title B—Part II of the act that capital net gain should be excluded

from net income (as defined by Section 21) if the taxpayer elected to be taxed thereon under Section 101.

Instead, Congress reenacted the capital gain and loss provisions first appearing in the 1921 Act in almost identical language in the 1924, 1926 and 1928 Acts. These reenactments were subsequent to and therefore a legislative approval of the construction previously placed upon the words of Congress by the Commissioner.

Brewster v. *Gage*, 280 U. S. 327.
United States v. *Falk*, 204 U. S. 143.
National Lead Co. v. *United States*, 252 U. S. 140.

In *White* v. *Atkins*, 69 Fed. 2d, 960, the Circuit Court of Appeals for the First Circuit, affirming the District Court decision of *Atkins* v. *White*, 3 Fed. Supp., 694, on facts similar to those of the case at bar, said at page 962—

> "There is nothing to indicate that Congress by the enactment of this provision for taxing capital net gains in the 1921 Act, in order to encourage greater activity in the sale of capital assets, intended thereby in any way to change the amount deductible for charitable contributions by limiting them to 15 per cent. of the individual's 'ordinary net income' instead of his net income as hitherto. The result is inconsistent with the purpose for which the deduction was allowed in the 1917 Act. If Congress had so intended by the provision for a flat rate assessment of capital gains, it would, we think, have made its intent clear. It has never done so.
>
> * * * We find no logical ground, derived from the history or prior construction of these acts, for holding that 'ordinary net income' as defined in Section 101 of the 1928 Act * * * is the base for limiting the deduction of contributions for charitable purposes under Section 23 (n) * * * .
>
> It is made clear in the 1932 Act that the provisions for the assessment of taxes when capital net gains and losses are involved are entirely separate from, and have no relation to, Sections 21, 22 and 23 of Part 2 of that Act. * * * Sub-title C * * * under which the provisions relating to capital net gains and

> capital net losses are found, provides that these provisions are merely supplementary to subtitle B in part 1 * * * which relates solely to rates and not to the manner of determining net income."

The Commissioner of Internal Revenue so interpreted the Congressional intent in applying the identical provisions of the 1921, 1924, 1926 and 1928 Revenue Acts prior to the decision of the Board of Tax Appeals in 1931 in *Elkins* v. *Commissioner,* 24 B. T. A. 572, involving capital net loss. The Court below summarized the acts of the Commissioner as follows (R. 29):

> "On February 6, 1923, the Deputy Commissioner telegraphed in response to an inquiry: 'Contributions; 15% limitation; Capital net gains: fifteen percent. limitation for deductions account charitable contributions applies to total net income inclusive of gain from sale of capital assets' (C. C. H. Fed. Income Tax Service, 1924, par. 2033). In 1924 a corresponding ruling as to capital losses was made: 'Capital losses cannot be excluded in computing net income for the purpose of determining the amount of charitable contribution deductions' (I. T. 404, Cum. Bul. III-2, p. 152). In 1928 the Government argued before this court that section 206 of the Revenue Act of 1921 (42 Stat. 232) (corresponding to section 101 of the 1928 act (26 U. S. C. A., § 2101)) related merely to rates and did not affect the computation of the allowance of charitable deductions, and we by dictum approved this construction (*Sadowsky* v. *Anderson* (C. C. A.) (29 F. (2d) 677, 679)). In November 1931 the Board of Tax Appeals decided *Elkins* v. *Com'r* (24 B. T. A. 572), and held, contrary to the ruling of the Bureau, that capital losses should be disregarded in computing the 15 percent. deduction for charitable contributions. The Commissioner announced that this decision was 'contrary to the position which the Bureau has consistently followed', and would be appealed (Int. Rev. Bul. XI-7, 5386; Mim. 3931)."

The same construction has been followed by the Board of Tax Appeals since the decision in 1933 in *Straus* v. *Com-*

missioner, 27 B. T. A. 1116, in which the Board, sitting as a whole, overruled the prior decisions of its individual members in the case at bar, *Colgate* v. *Commissioner,* 27 B. T. A. 506, and *Harbison* v. *Commissioner,* 26 B. T. A. 896, each of which involved capital net gain.*

The present change of position of the Commissioner is without basis in any court decision or reasonable rule of construction.

If there be any ambiguity in the statute it should be construed most strongly against the Commissioner and in favor of the purpose of the act as already defined by the courts.

Gould v. *Gould,* 245 U. S. 151, 62 Law Ed. 211.

United States v. *Updike,* 281 U. S. 489, 74 Law Ed. 984.

Old Colony R. Co. v. *Commissioner,* 284 U. S. 552, 76 Law Ed. 484.

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* For the information of the Court we list here every case involving capital net gains which has come to our attention with its present status. Aside from the case at bar, these are:

Harbison v. *Commissioner,* C. C. A. 2d, 68 Fed. (2d) 1004, reversing 26 B. T. A. 896, certiorari granted *sub nom. Helvering* v. *Harbison,* 78 Law Ed. 863, No. 7, October Term 1934, to be argued together with case at bar.

Colgate v. *Commissioner,* C. C. A. 2d, unreported, reversing 27 B. T. A. 506, certiorari granted *sub nom. Helvering* v. *Colgate,* 78 Law Ed. 863, No. 8, October Term 1934.

White v. *Atkins* C. C. A. 1st, 69 Fed. 2d, 966, affirming *Atkins* v. *White,* District Mass. 3 Fed. Supp. 694.

Blow v. *United States,* Northern District Ill. 5 Fed. Supp. 737, pending after argument on appeal to the Circuit Court of Appeals for the Seventh Circuit.

Straus v. *Commissioner,* 27 B. T. A. 1116 pending after argument on petition for Review in Court of Appeals, District of Columbia.

Robinette v. *Commissioner,* 27 B. T. A. 1426 pending after argument on petition for review in the Circuit Court of Appeals, for the Third Circuit.

Iglehart v. *Commissioner,* 27 B. T. A. 1426, pending after argument on petition for review in the Circuit Court of Appeals for the Seventh Circuit.

Woodward v. *Commissioner,* 27 B. T. A. 1426, pending on petition for review in the Circuit Court of Appeals for the Second Circuit.

POINT III.

The judgment of the Circuit Court of Appeals for the Second Circuit should be affirmed.

Respectfully submitted,

JAMES McKINLEY ROSE,
Counsel for Respondent.

R. L. VON BERNUTH,
MORRELL S. LOCKHART,
JOHN F. BOYER,
Of Counsel.

APPENDIX.

Revenue Act of 1928, c. 852, 45 Stat. 791:

TITLE I—INCOME TAX.

SUBTITLE B—GENERAL PROVISIONS.

Part I—Rates of Tax.

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax equal to the sum of the following:

(Here follows list of rates)

SEC. 12. SURTAX ON INDIVIDUALS.

(a) **Rates of surtax.**—There shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows:

(Here follows list of rates)

* * * * * * *

(c) **Capital net gains and losses.**—For rate and computation of tax in lieu of normal and surtax in case of net incomes of not less than $30,000, approximately, or in case of net incomes, excluding items of capital gain, capital loss, and capital deductions, of not less than $30,000, approximately, see section 101.

* * * * * * *

Part II—Computation of Net Income.

SEC. 21. NET INCOME.

'Net income' means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) **General Definition.**—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of what-

ever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(n) **Charitable and other contributions.**—In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

* * * * * * *

(2) Any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, * * *;

* * * * * * *

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. * * *.

* * * * * * *

SEC. 25. CREDITS OF INDIVIDUAL AGAINST NET INCOME.

There shall be allowed for the purpose of the normal tax, but not for the surtax, the following credits against the net income:

(a) **Dividends.**—The amount received as dividends—

(1) from a domestic corporation, or

(2) from a foreign corporation when it is shown to the satisfaction of the Commissioner * * *

(specifying conditions under which credit will be allowed)

* * * * * * *

(b) **Interest on United States Obligations.**—The amount received as interest upon obligations of the United States which is included in gross income under section 22.

* * * * * * *

Part III—Credits Against Tax.

SEC. 31. EARNED INCOME CREDIT.

(a) **Definitions.**—For the purposes of this section—

(1) 'Earned income' means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income producing factors, a reasonable allowance as compensation for the personal services actually rendered by the taxpayer, not in excess of 20 per centum of his share of the net profits of such trade or business, shall be considered as earned income.

(2) 'Earned income deductions' means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against earned income.

(3) 'Earned net income' means the excess of the amount of the earned income over the sum of the earned income deductions. If the taxpayer's net income is not more than $5,000, his entire net income shall be considered to be earned net income, and if his net income is more than $5,000, his earned net income shall not be considered to be less than $5,000. In no case shall the earned net income be considered to be more than $30,000.

(b) Allowance of Credit.—In the case of an individual the tax shall be credited with 25 per centum of the amount of tax which would be payable

if his earned net income constituted his entire net income; but in no case shall the credit allowed under this subsection exceed 25 per centum of his normal tax plus 25 per centum of the surtax which would be payable if his earned net income constituted his entire net income. This credit shall be in addition to all other credits against the tax.

* * * * * * *

Part IV—Accounting Periods and Methods of Accounting.

* * * * * * *

Part V—Returns and Payment of Tax.

* * * * * * *

SUBTITLE C—SUPPLEMENTAL PROVISIONS.

Supplement A—Rates of Tax.

(Supplementary to Subtitle B, Part I.)

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) **Tax in case of capital net gain.**—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) **Tax in case of capital net loss.**—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the

manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) **Definitions.**—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years * * *.

* * * * * * *

(d) **Collection and payment of tax.**—The total tax determined under subsection (a) or (b) shall be collected and paid in the same manner, at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

* * * * * * *

Supplement B—Computation of Net Income.

(Supplementary to Subtitle B, Part II.)

* * * * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) **General rule.**—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(Here follow directions as to the methods of determining gain or loss.)

* * * * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) **Property Acquired After February 28, 1913.**—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

(Here follows enumeration of exceptions.)

* * * * * * *

(b) **Property Acquired before March 1, 1913.**—The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(Here follows description of methods.)

* * * * * * *

SEC. 120. UNLIMITED DEDUCTION FOR CHARITABLE AND OTHER CONTRIBUTIONS.

In the case of an individual if in the taxable year and in each of the ten preceding taxable years the amount of the contributions or gifts described in section 23 (n) plus the amount of income, war-profits, or excess-profits taxes paid during such year in respect of preceding taxable years, exceeds 90 per centum of the taxpayer's net income for each such year, as computed without the benefit of section 23(n), then the 15 per centum limit imposed by such section shall not be applicable.

Supplement C—Credits Against Tax.

(Supplementary to Subtitle B, Part III.)

* * * * * * *

Supplement D—Returns and Payment of Tax.

(Supplementary to Subtitle B, Part V.)

* * * * * * *

Revenue Act of 1924, c. 234, 43 Stat. 253:

SEC. 207. (b) If a fiscal year of a partnership begins in one calendar year and ends in another calendar year, and the law applicable to the second calendar year is different from the law applicable to the first calendar year, then (1) the rates for the calendar year during which such fiscal year begins shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year. In such cases the part of such income subject to the rates in effect for the most recent calendar year shall be added to the other income of the taxpayer subject to such rates and the resulting amount shall be placed in the lower brackets of the rate schedule applicable to such year, and the part of such income subject to the rates in effect for the next preceding calendar year shall be placed in the next higher brackets of the rate schedule applicable to such year.

(U. S. C., Title 26, Sec. 938.)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 7.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

WILLIAM ALBERT HARRISON.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT.

James E. McCormick, Jr.,
Farmers Bank Building,
Pittsburgh, Pennsylvania.
Hugo Hamilton,
30 Broad Street,
New York, New York.
Attorneys for the Respondent.

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WILLIAM ALBERT HARBISON.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals (R. 15–18) is reported in 26 B. T. A. 896. The opinion of the Circuit Court of Appeals (R. 25) is reported in 68 Fed. (2d) 1004.

JURISDICTION.

The jurisdiction of this court is by virtue of Section 240 (a) of the Judicial Code, as stated in the petitioner's brief.

QUESTION PRESENTED.

Where the taxpayer elects to be taxed under Section 101 (a) of the Revenue Act of 1928, does "net income," by which the maximum 15 per cent. deduction from gross income allowable for contributions under Section 23 (n) of the Revenue Act of 1928 is measured, include capital net gain?

Statutes Involved.

The statutes involved are Sections 21, 22 (a), 23 (n) and 101 of the Revenue Act of 1928 (c. 852, 45 Stat. 791), as follows:

"TITLE I.—INCOME TAX.

PART II.—COMPUTATION OF NET INCOME.

SEC. 21. NET INCOME.

'Net income' means the gross income computed under Section 22, less the deductions allowed by Section 23.

SEC. 22. GROSS INCOME.

(a) *General definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

SEC. 23. DEDUCTIONS FROM NET INCOME.

In computing net income there shall be allowed as deductions: * * *

(n) *Charitable and other contributions.*—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * *

(2) Any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual; * * * to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection.

SUBTITLE C—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A—RATES OF TAX.

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) *Tax in case of capital net gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) *Tax in case of capital net loss.*—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) *Definitions.*—For the purposes of this title—

(1) 'Capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) 'Capital loss' means deductible loss resulting from the sale or exchange of capital assets.

(3) 'Capital deductions' means such deductions as are allowed by Section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) 'Ordinary deductions' means the deductions allowed by Section 23 other than capital losses and capital deductions.

(5) 'Capital net gain' means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) 'Capital net loss' means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) 'Ordinary net income' means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions."

Statement.

The facts as stipulated and found are as follows (R. 11–15, 21, 22):

The taxpayer during the taxable year 1928 had net income of $111,648.39, as defined by Section 21 of the Revenue Act of 1928, but before any allowance of a deduction for charitable contributions as provided for by Section 23 (n). Of such statutory net income $66,634.87 was ordinary net income and $45,013.52 was capital net gain, as defined by Section 101 (c). The taxpayer elected to have his capital net gain taxed under the capital net gain provisions in Section 101.

During the taxable year he made charitable contributions within the scope of Section 23 (n) amounting to $27,996.83. He claimed in his tax return, as a deduction for such charitable contributions, the sum of $16,747.26, which was equal to 15 per cent. of his statutory net income of $111,648.39 as computed without the benefit of the deduction for charitable contributions. In auditing the taxpayer's return the Commissioner, consistently with his uniform practice, determined and allowed a deduction for contributions equal to 15 per cent. of the

taxpayer's entire net income, including capital net gain (R. 5, 6), but while this proceeding was pending before the Board, and because of the view then temporarily taken by the Board in the *Elkins* case, the Commissioner filed an amended answer alleging error in such allowance. (R. 10.) The Board of Tax Appeals decided that his charitable contributions should be limited to 15 per cent., not of his net income, but of his ordinary net income. The Circuit Court of Appeals reversed the Board and held that the taxpayer's computation and the Commissioner's original computation are correct.

Summary of Argument.

Stripped of legal verbiage the question in essence is whether or not the whole is equal to the sum of its parts.

The statute provides (Section 23 (n)) that the 15 per cent. limitation shall be based on "net income." The Government's present contention is that, where the taxpayer elects to have his capital net gain subjected to tax under Section 101 of the statute, the 15 per cent. limitation shall be based on ordinary net income instead of net income, although it is not disputed that capital net gain is included in net income. According to the Government, the sum of capital net gain plus ordinary net income is not equal to, but exceeds, net income. The fallacy in the Government's contention lies in attempting to apply Section 101 before the net income, upon which the deduction for contributions is based, is determined under Sections 21, 22 and 23, and in failing to recognize that Section 101 provides only for the calculation of the tax and for the classification of net income, and not at all for the determination of net income. The Government confuses the two operations of the computation of net income and the computation of the tax.

For a number of years the revenue acts have allowed a deduction from gross income for charitable contributions limited to 15 per cent. of net income before deducting such charitable

contributions. In the Revenue Act of 1921 provision was made for an optional tax on net gain derived from the sale of capital assets held over two years, and for the purpose of computation of such tax net income was divided into capital net gain and ordinary net income. In the Revenue Act of 1924 the provision was extended to apply to capital net losses. Until 1932 the construction of the statute by the Treasury Department was consistent that both capital net gain and capital net loss, being part of net income, should be taken into account in determining the maximum deduction for charitable contributions. The Government's present position is not supported by the Board of Tax Appeals or by the courts.

The respondent accordingly maintains the following propositions:

1. A taxpayer is entitled to the allowance as a deduction in computing his net income of charitable contributions to an amount which does not exceed 15 per cent. of his net income as computed without the benefit of such deduction, irrespective of whether or not the taxpayer's net income includes capital net gain.

2. The rulings and practice of the Bureau of Internal Revenue from 1917 to 1932 have consistently allowed for charitable contributions 15 per cent. of the taxpayer's net income, including capital net gain.

3. The 15 per cent. charitable deduction provision was placed in the Revenue Acts for the benefit of charitable institutions and to encourage charitable giving, and the Act should be interpreted to accomplish this result.

4. The argument advanced by the Commissioner, besides being opposed to his own long-continued administrative construction under several reenactments of similar provisions of law, has been rejected by the Board of Tax Appeals and the Federal Courts.

ARGUMENT.

I.

A taxpayer is entitled to the allowance as a deduction in computing his net income of charitable contributions to an amount which does not exceed 15 per cent. of his net income as computed without the benefit of such deduction, irrespective of whether or not the taxpayer's net income includes capital net gain.

Section 23 (n) provides that in computing net income there shall be allowed as a deduction charitable contributions to an amount which does not exceed 15 per cent. of the taxpayer's "net income" as computed without the benefit of such deduction. Accordingly, charitable contributions are deductible in computing net income to the extent that they do not exceed 15 per cent. of net income before deducting such contributions. There is no other limitation, and the amount of the deduction for charitable contributions is readily determinable and fixed as soon as the amount of charitable contributions and the amount of the net income as computed without the benefit of the deduction of such charitable contributions are known. If, then, the charitable contributions are $15,000 and the net income before deducting such contributions is $100,000, it is clear that $15,000 may be deducted from the $100,000 in computing net income.

But what does the statute mean by "net income"? As the meaning of this term is defined in the statute itself, there is no uncertainty as to its meaning. We have only to look to section 21, which provides that "net income" means the gross income computed under section 22, less the deductions allowed by section 23. This is the sole and exclusive definition of net income in the statute.

As was stated by the Circuit Court of Appeals for the Second

Circuit, in *American Can Co.* v. *Bowers*, 35 Fed. (2d) 832, 835, certiorari denied, 281 U. S. 736,

> "Necessarily, net income, for tax purposes, is a conception of the income tax statute, and the amount arrived at is ascertained by deducting from the gross amount of income received by the taxpayer from *all sources* the specified deductions allowed to it by statute." (Italics ours.)

Referring to section 22, it appears that gross income includes gains, profits and income derived, among other things, from dealings in property, and, in general, gains, profits and income derived from any source whatever. It is evident that gain from the sale of capital assets is included in gross income. Referring further to section 23, we find that various deductions are allowable from gross income in computing net income, and that among them is the provision for the deduction of charitable contributions under section 23 (n), already discussed. Adopting the figures used above, there is no room for dispute, therefore, that the net income in our supposititious case is $85,000.

Now it does not follow that all portions of our net income of $85,000 may be taxed at the same rates or in the same manner. Section 25 provides that for the purpose of the normal tax there shall be credited against net income dividends, interest on United States obligations, the personal exemptions for single and married persons, and the credit for dependents, so that not all of the net income is subject to normal tax, but only to surtax. Section 31 provides for a special classification of net income in the form of earned net income, and taxes earned net income at a lower rate than other net income. Section 102 provides that in the case of gains from the sale of mines, where the principal value of the property has been demonstrated by prospecting, exploration and discovery work done

by the taxpayer, the surtax shall not exceed 16 per cent. of the selling price. None of these provisions or others similar to them affects the determination of net income, which is solely subject to the provisions of sections 21, 22 and 23, above cited.

Having seen that the determination of net income is expressly and definitely provided for, and that various classes of net income may be differently taxed without disturbing the computation of net income, we pass to section 101, which provides for the tax in respect of capital net gain, which is merely another division or class of net income. In this section capital net gain is contrasted with ordinary net income, and even before scrutinizing the statutory provisions it would appear logical and sensible that such part of net income as was not capital net gain would be ordinary net income. In other words, the sum of capital net gain and ordinary net income would necessarily be net income. This conclusion is supported by sections 168 and 186 relating respectively to capital net gains and losses in the cases of estates or trusts and partnerships, both sections providing that "the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under rules and regulations," etc.

But, naturally, the provisions of section 101, unless ambiguous, must control. Perhaps we should first examine the definition of our terms. "Capital gain" and "capital loss" give little trouble, and "capital deductions" and "ordinary deductions" expressly include all the deductions allowed by section 23. In order to arrive at capital net gain there is subtracted from the capital gain the sum of the capital deductions and capital losses, plus any amount by which the ordinary deductions exceed the gross income computed without including capital gains, which means that if the ordinary deductions exceed the gross income exclusive of capital gains, then net

income comprises solely capital net gain. The definitions just mentioned are helpful, but perhaps not conclusive.

Apparently the crux of the matter, aside from the definition of net income, is the definition of ordinary net income. Subdivision (7) of paragraph (c) of section 101 provides:

> "(7) 'Ordinary net income' means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions."

By ordinary rules of grammar, the second clause, "computed in accordance with the provisions of this title," merely explains and identifies what is meant by the expression "net income." In other words, section 101, where it speaks of net income, means the net income which has been computed in accordance with sections 21, 22 and 23, but "ordinary net income" means such net income after excluding all items of capital gain, capital loss and capital deductions, that is to say, after excluding capital net gain, or capital net loss. The only other possible construction would be to pay no attention to the second comma, between "title" and "after," and attempt to arrive at an anomalous net income by first excluding items of capital gain, capital loss, and capital deductions. That, however, would not be net income, and an analysis of the provision can leave no doubt that one must start with net income as computed in accordance with sections 21, 22, and 23, and then exclude all items of capital gain, capital loss and capital deduction in arriving at ordinary net income.

Were there no statutory definition of "net income," as in section 21, the definition of "ordinary net income" in section 101 (c) (7) would alone suffice to show beyond any question that capital gain is included in "net income," for the provision excluding capital gain, capital loss and capital deductions from net

income in order to arrive at ordinary net income would be meaningless unless capital gain, capital loss and capital deductions were used in computing net income to start with.

There is further internal evidence that capital gains were intended to be included in gross income for the purpose of computing the net income on which the deduction for contributions is based. Section 101 (c) (5) defines "capital net gain" as the excess of total capital gain over the sum of (A) capital deductions and capital losses plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains. Why should the Congress specify "gross income" computed without including capital gains, unless where the term is used without such limitation, as in section 22, "gross income" includes capital gains?

A further clear indication that all items of gross income and deductions that may be found in the statute are included in sections 22 and 23, is derived from the fact that sections 101 (c) (3) and 101 (c) (4) show plainly that the capital deductions and ordinary deductions are, together, those deductions found in section 23.

Referring to our original illustration of net income of $100,000 before deduction of contributions and net income of $85,000 determined by deducting contributions of $15,000, let us assume that such net income is made up of capital net gain of $45,000 and ordinary net income of $40,000. As we have seen, section 101 does not require a recomputation of net income, but merely the division, for the purpose of calculating the tax, of net income *previously computed* into the two classes of capital net gain and ordinary net income. As in calculating the capital net gain, it may be assumed, we did not take into account the deduction of $15,000 for charitable contributions, that being an ordinary deduction, it follows, since

the sum of capital net gain and ordinary net income equals net income, that automatically the deduction of $15,000 for charitable contributions is given effect in arriving at ordinary net income.

Having seen that the meaning of the terms used is clear, the operating provisions of section 101 present no issue. Paragraph (a) provides that in the case of any taxpayer, other than a corporation, who derives capital net gain, there shall at the election of the taxpayer be paid in lieu of other taxes a tax determined by first computing a partial tax upon the basis of the ordinary net income at the rates and in the manner as if section 101 had not been enacted and by regarding the total tax as such amount plus 12½ per cent. of the capital net gain. There is no suggestion here of recomputing net income; there is simply a special provision for determining a tax upon net income which includes or comprises capital net gain. There is no more necessity for recomputing net income than there would be where net income includes dividends, earned income or interest on Government bonds.

That the capital net gains provisions simply prescribe a rate of tax on a *kind* of net income is disclosed by a reference to the title of the provisions. The title is "SUBTITLE C—SUPPLEMENTAL PROVISIONS," "SUPPLEMENT A—RATES OF TAX," followed by the specific provisions of Section 101, "Capital net gains and losses." The provisions are part of Title I of the Act, which covers all income tax. More specifically, the capital net gains and losses provision, by its own caption, has reference entirely to "rates of tax" applicable to the capital net gains and losses provisions of the "income tax" title of the act. The purpose is plain to impose a different rate of tax on capital gains from the rates applicable to other kinds of net income.

Moreover, it is to be noted from Judge Swan's opinion in the *Bliss* case that in 1928 the Government was arguing in his

Court that the capital gains provisions related "merely to rates and did not affect the computation of the allowance of charitable deductions," which argument was accepted by the Second Circuit at that time and tacitly approved by this Court in denying a writ of certiorari in *Sadowsky* v. *Anderson*, 29 Fed. (2d) 677, certiorari denied, 279 U. S. 849.

Furthermore, the record in this case shows that, in determining the deficiency against this taxpayer, the Commissioner referred to the taxpayer's "Net income including capital gain as shown on return," increased the capital gain, and consequently increased proportionately the deduction for contributions, and then stated the taxpayer's "Net income adjusted,"—in which he included capital gains. See the Commissioner's deficiency letter to the taxpayer. (R. 5.)

The inference conveyed by the foot note to the Commissioner's brief in the *Bliss* case (page 12) is therefore somewhat misleading, unless it be considered in connection with the further explanation that the tax returns prescribed by the Internal Revenue Bureau make provision for the separate statement of each of the different kinds of net income received by a taxpayer, such as wages, interest, dividends, partnership profits, capital gains and the like, all for convenience in auditing the returns and applying the proper rates of tax to the different kinds of income.

The Commissioner's argument necessarily suggests that perhaps Congress meant to penalize a taxpayer for taking advantage of the tax on capital net gains. Certainly no evidence of any such intention exists in the statute. The provision for the special taxation of capital net gains was designed at least as much for the benefit of the Government as of taxpayers, it being thereby intended to enable taxpayers to realize gain taxable at a reasonable rate on the sale of property which they could not afford to sell if the gain were to

be subject to high surtaxes. It was thought that by removing the prohibitive tax theretofore applied upon profits derived from the sale of capital items, the effect would be to "materially increase the revenue" by stimulating profit-taking transactions. See House Report No. 350, 67th Congress, First Session, and Senate Report No. 275, 67th Congress, First Session, p. 12. Also see the discussion in Congress, Congressional Record, Vol. 61, Part 5, pages 5175–76, 5289; Vol. 61, Part 7, page 6576. Cf. *Burnet* v. *Harmel*, 287 U. S. 103, 106; *Helvering* v. *New York Trust Co.*, 54 S. Ct. 806. The provision is clearly remedial legislation.

The fallacy in the Commissioner's argument herein lies, we think, in attempting to apply section 101 before the net income upon which the deductions for contributions is based is determined under sections 21, 22 and 23, and in failing to recognize that section 101 provides only for the calculation of the tax and for the classification of net income, and not at all for the determination of net income. The effect of the Commissioner's contention is to call for the computation of a hybrid net income which is neither the net income determined under sections 21, 22 and 23 as prescribed by the statute, nor ordinary net income defined by section 101 and to be calculated by excluding from net income all items of capital gain, capital loss and capital deductions. We venture to repeat and to emphasize that before resorting to section 101 the taxpayer's net income must first be determined under sections 21, 22 and 23, involving the deduction from gross income of all the allowances specified in section 23, including charitable contributions up to 15 per cent of the taxpayer's net income (as defined in section 21) before deducting such charitable contributions. Once statutory net income be determined, the proper application of section 101 is not confusing.

The interpretation herein contended for is in harmony with

the obvious meaning of the words "net income" as used elsewhere in the same act.

Section 120 of the Revenue Act of 1928 provides as follows:

> "SEC. 120. UNLIMITED DEDUCTIONS FOR CHARITABLE AND OTHER CONTRIBUTIONS.
>
> "In the case of an individual if in the taxable year and in each of the ten preceding taxable years the amount of the contributions or gifts described in section 23 (n) plus the amount of income, war-profits, or excess-profits taxes paid during such year in respect of preceding taxable years, exceeds 90 per centum of the taxpayer's net income for each such year, as computed without the benefit of section 23 (n), then the 15 per centum limit imposed by such section shall not be applicable."

There certainly is no doubt what Congress intended by the words "net income" in this section; it means net income as defined by section 21 and it does not mean "ordinary net income." The purpose of Congress is clear in the case of the person who for ten years pays out 90 per cent of his income for charity or taxes; the 15 per cent limitation does not apply to him if he gives away practically all his money to charity. In Report No. 398, Sixty-fifth Congress, First Session, Senate Finance Committee, covering the Revenue Act of 1924, it is stated, on the subject of the unlimited deduction for charitable contributions, at page 24 as follows:

> "This provision is designed substantially to free from income taxation one who is habitually contributing to benevolent organizations amounts equalling virtually his entire income."

The Commissioner would not argue that net income in section 120 meant "ordinary net income" and not exactly what the section says—"net income," which is clearly defined in section 21.

We have previously pointed out that in Section 168, relating to estates and trusts, and in Section 186, relating to partnerships, the 1928 Act provides that a beneficiary's or partner's "proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under rules and regulations to be prescribed by the Commissioner," etc. Here, if any further definition than that contained in Section 21 were required, is an explicit statutory declaration that "net income" includes capital net gains.

The interpretation contended for by the Commissioner would produce absurd results.

As an illustration of the inequitable operation of the statute, under the Commissioner's present argument, assume three taxpayers who have made charitable contributions of $50,000.00 each and whose respective incomes are as follows:

	A.	B.	C.
Gain (or loss) from business	($100,000.00)	$100,000.00	$300,000.00
Gain (or loss) from the sale of capital assets	300,000.00	100,000.00	(100,000.00)
Net income (before a deduction for contributions)	200,000.00	200,000.00	200,000.00

In accordance with the provisions of section 23 (n) and the statutory definition of "net income," there is an allowable deduction for contributions, within the 15 per cent limitation, of $30,000.00 in each of the above cases. Following the Commissioner's contention, the amount of the deduction would be determined not by the *amount* of net income, but by the *kind* of net income. Under that view, A would be allowed a deduction for contributions of zero, B a deduction of $15,000.00 and C a deduction of $45,000.00,—despite the fact that each has the same statutory net income. The statute, however, reenacted several times without change in this regard and

consistently so interpreted in its administration, has made the amount of the deduction for charitable contributions depend on the *amount* and not on the *kinds* of net income.

It is not to be presumed, without clear provision to the contrary, that taxpayers having the same economic and statutory net income are to be treated so differently.

The phrase "net income" is a phrase of technical meaning, as pointed out in *American Can Co.* v. *Bowers*, *supra*, being a phrase of statutory conception. Its technical meaning is defined in the statute itself. The phrase having been given in legal formulae a fixed, definite and certain meaning, that meaning is conclusively presumed to be what Congress meant in the premises. *Central Union Trust Co.* v. *Edwards*, 287 Fed. 324, 326, certiorari denied, 262 U. S. 744. Therefore, there is no possible ground, if otherwise under any circumstances any existed, for the Commissioner's resort for a meaning of the phrase, as he has in his brief in the *Bliss* case, to the language used by a private citizen before a committee of Congress in informal discussion at hearings on a bill much amended in its passage. Congress itself having defined the phrase, no judicial body has the power to give it a different meaning. *Schweizer* v. *Mager*, 297 Fed. 334, 335; *In re Monrovia Evening Post*, 199 Calif. 263, 248 Pac. 1017, 1020.

Moreover, the phrase "net income" having been defined in the Act, where the same phrase is used elsewhere in the Act, as in section 23 (n), it is presumed to have been used with the same meaning. *United States* v. *Merriam*, 263 U. S. 179. That Congress intended the phrase to have the same meaning wherever used in the act is conclusively shown by reference to Sections 168 and 186, referred to *ante*, p. 9.

II.

The rulings and practice of the Bureau of Internal Revenue from 1917 to 1932 have consistently allowed for charitable contributions 15 per cent. of the taxpayer's net income, including capital net gains.

The deductions for charitable contributions were first authorized by the Revenue Act of 1917, Section 1201 (2) (40 Stat. 330). The regulations relating to that Act (Reg. 33 Rev.) interpreting this provision, provided as follows:

> "Par. 88. Taxable net income, as used in Section 5 (a), ninth deduction, is construed to mean gross income, less deductions (except ninth deduction above) and less excess profits tax, if any."

The Revenue Act of 1917 did not provide for capital net gains or capital net losses; these features of our present Revenue Acts were introduced later. The capital net gain provisions was introduced in the Act of 1921 and the capital net loss feature was introduced in the Act of 1924. However, even after the passage of the Act of 1921, and also the Act of 1924, introducing the capital net gain and loss provisions, no change was made by the Bureau of Internal Revenue in the computation of net income so far as charitable deductions were concerned. The policy with respect to Capital Gains is set forth in a telegram to A. B. Trudgian, New York, signed by the Deputy Commissioner, E. W. Chatterton, and dated February 6th, 1923 (Corp. Trust Co. Fed. Income Tax Service, 1924, Par. 2033):

> "Contributions; 15% limitation; Capital Net Gains: fifteen per cent. limitation for deductions account charitable contributions applies to total net income inclusive of gain from sale of capital assets."

This was followed by a ruling of the Commissioner, promulgated in 1924,—I. T. 2104, Cum. Bull. III-2, p. 152, with respect to Capital Losses, as follows:

"Article 251: Charitable contributions. III-45-1863 I. T. 2104.

"Revenue Acts of 1918, 1921 and 1924.

"Capital losses can not be excluded in computing net income for the purpose of determining the amount of charitable contribution deductions.

"Advice is requested as to whether capital losses may be excluded in determining net income for the purpose of computing the amount of charitable contributions allowable as deductions under the Revenue Acts of 1918, 1921 and 1924.

"Under the provisions of Section 214 (a) 11 of the Revenue Acts of 1918 and 1921 and Section 214 (a) 10 of the Revenue Act of 1924, contributions or gifts made by an individual to organizations organized and operated exclusively for charitable or other specified purposes are deductible to an amount not in excess of 15 per cent. of the taxpayer's net income, including such payments.

"Section 212 of the Revenue Acts of 1918 and 1921 defines the term 'net income' as follows:

"(a) That in the case of an individual the term 'net income' means the gross income as defined in Section 213, less the deductions allowed by Section 214.

"Net income is defined by Section 212 of the Revenue Act of 1924 as follows:

"(a) In the case of an individual the term 'net income' means the gross income as defined in Section 213, less the deductions allowed by Sections 214 and 206.

"Section 206 of the Revenue Act of 1921 and Section 208 of the Revenue Act of 1924, pertaining to capital gains and losses, do not allow as a deduction any loss resulting from the sale or exchange of capital assets that is not deductible under Section 214 or that does not enter into the computation of a net loss deductible under Section 206

of the Revenue Act of 1924. Such sections merely give the taxpayer the option of being taxed at the rate and in the manner therein provided instead of at the rates and in the manner provided by Sections 210 and 211.

"Inasmuch as losses resulting from the sale or exchange of capital assets are deductible under Section 214 of the Revenue Acts of 1918, 1921, and 1924, and enter into the computation of the net loss that is deductible under Section 206 of the Revenue Act of 1924, it follows that such losses can not be excluded in computing the net income for the purpose of determining the amount of charitable contributions that are deductible under Section 214 (a) 11 of the Revenue Acts of 1918 and 1921 and Section 214 (a) 10 of the Revenue Act of 1924."

The case of *Hallie D. Elkins* v. *The Commissioner*, 24 B. T. A. 572, was decided by the Board of Tax Appeals November 3d, 1931. It held that where the taxpayer had sustained capital net losses, these capital net losses should be disregarded in the computation of charitable gifts to the extent of 15 per cent of the taxpayer's net income. This decision was contrary to the above I. T. 2104, and the Commissioner, on January 27th, 1932, referring to the *Elkins* case (Mim. 3931, XI-1 C. B. 33) said:[1]

"The Board's decision is contrary to the position which the Bureau has consistently followed as announced in I. T. 2104 (C. B. III-2, 152). The decision will be appealed, and in the audit of returns involving capital net losses, the Bureau will continue to follow I. T. 2104."

Thus, the Commissioner himself admitted that he had

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[1] The Commissioner, as indicated in his mimeograph 3931, recommended that the Board's decision in the *Elkins* case be appealed, but the then Solicitor General refused to authorize an appeal.

consistently followed the position here urged by the petitioner; and that his rules and regulations favorable to the respondent were consistently followed by him, although changes were made in the law by the Act of 1921 and the Act of 1924. As was stated by the Supreme Court in *Brewster* v. *Gage*, 280 U. S. 327:

> "These regulations were prepared by the Department charged with the duty of enforcing the Acts. The rule so established is reasonable and does no violence to the letter or spirit of the provisions construed. A reversal of that construction would be likely to produce inconvenience and result in inequality. It is the settled rule that the practical interpretation of an ambiguous or doubtful statute that has been acted upon by officials charged with its administration will not be disturbed except for weighty reasons."

It is a well settled rule of construction that if Congress re-enacts a statute in substantially the same terms as a prior Act and there has been an administrative or judicial construction of the prior Act, it is tantamount to the adoption of that construction, for Congress is presumed to have knowledge of such construction. *United States* v. *Falk*, 204 U. S. 143, and *National Lead Co.* v. *United States*, 252 U. S. 140. In the latter case, the Court said:

> "* * * It has been the settled law that when uncertainty or ambiguity, such as we have here, is found in a statute, great weight will be given to the contemporaneous construction by Department officials, who were called upon to act under the law and to carry its provisions into effect,—especially where such construction has been long continued, as it was in this case for almost forty years before the petition was filed. * * *
>
> "To this we must add that the Department's interpretation of the statute has had such implied approval

by Congress that it should not be disturbed, particularly as applied to linseed and its products."

It will be remembered that since the Act of 1917 was passed and the first regulation was made by the Commissioner of Internal Revenue, not only have the Acts of 1921 and 1924 been passed, with their relative regulations and rulings above referred to, but also the Acts of 1926, 1928 and 1932 have been passed and Congress has made no change in the law.

Though the assertion is made in the Government's brief in the *Bliss* case (page 24) that, following the *Elkins* decision, the Bureau's position has been entirely consistent with the position taken in this case, a consideration of the facts indicates the contrary.

Following the *Elkins* decision, as we have pointed out, the Commissioner published Mim. 3931, stating that the *Elkins* decision was contrary to his position and would be appealed, and providing in effect that the procedure to be followed in all cases involving the issue was that the view most favorable to the Government was to be taken. However, the Solicitor General refused to authorize an appeal. Consequently all the Commissioner could do was to refuse to follow the *Elkins* decision, which he did. Thereafter the Board's opinion in the *Harbison* case was promulgated and Mim. 3986 was published (XI-2 C. B. 29), stating that the Bureau's original position in I. T. 2104 was to be followed in certain respects and that the Board's position in the *Harbison* case was to be followed in others. In G. C. M. 11324 (XI-2 C. B. 267), the next official pronouncement, the view was taken that the original position of the Bureau was correct under the 1918 and 1921 Acts, and I. T. 2104 was modified only to the extent that it was affected by the Board's decision in the *Elkins* case under the 1924 Act.

Following the *Straus* decision, the Commissioner directed that in the audit of returns "in order fully to protect the interests of the Government and the taxpayers pending a final decision of court on the question" certain procedure be followed. See I. T. Mim. 4028, 1933 C. C. H., para. 6323.

III.

The 15 per cent. charitable deduction provision was placed in the Revenue Acts for the benefit of charitable institutions and to encourage charitable giving, and the Act should be interpreted to accomplish this result.

The issue before this Court is not merely how much taxes the respondent must pay; it is an issue that vitally concerns all charities. The religious, charitable, scientific, literary and educational institutions are as much interested in the decision of this Court as the respondent. The provision allowing charitable deductions to the extent of 15 per cent. of the taxpayer's net income was first inserted in the Act of 1917. Senator Hollis, in his amendment to the Act, proposed a deduction of 20 per cent., and, when he introduced his amendment on September 7, 1917, said (Congressional Record, Vol. 55, Part 7, page 6728):

> "The effect of that amendment will be to permit a wealthy man to contribute to charitable, educational and scientific institutions, and then when he comes to make up his income tax return to make a deduction from his gross income of the amount that he has contributed for these purposes, not to exceed 20 per cent. of his entire net income. * * * I understand ex-President Taft has written to the Committee stating that, in his judgment, institutions like Hampton Institute will be seriously handicapped unless this amendment is adopted.

> "It will work in this way: usually people contribute to charities and educational objects out of their surplus. After they have done everything else they want to do, after they have educated their children and travelled and spent their money on everything they really want or think they want, then, if they have something left over, they contribute it to a college, or to the Red Cross or for some scientific purposes. Now, when war comes and we impose these very heavy taxes on income, that will be the first place where the wealthy man will be tempted to economize, namely, in donations to charity."

On his agreeing to alter the amount from 20 per cent. to 15 per cent., the amendment was adopted.

Many of the large contributions to charitable institutions are made by taxpayers when they derive a substantial capital gain; it is only human nature to give more abundantly when one has realized handsomely upon a fortunate investment than when one has merely a fixed income or sustains losses. The point is well illustrated in this case. The respondent gave liberally in aid of worthy causes. While his total taxable income, without any deduction for contributions, was only $111,648.39, he made contributions in the amount of $27,996.83.

Congress adopted in 1917 the policy of encouraging charitable gifts to sustain charitable institutions. That the provisions allowing a deduction for charitable contributions was intended by Congress to encourage charitable gifts is recognized by the Bureau of Internal Revenue. See Law Opinion 1118, II-2, C. B. 148. The construction now contended for by the Commissioner would absolutely destroy this incentive when the taxpayer has made capital gains; the construction contended for by the respondent fulfills the purpose of Congress and such an interpretation should be sustained.

Moreover, for years past, while the Commissioner was

consistently following his rules and regulations during the various enactments of new revenue laws, people who had made large capital gains, relying upon such rules and regulations, gave liberally to charities, feeling assured that they could deduct the amount of their gifts up to 15 per cent. of their net incomes. The position as now contended for by the Commissioner is, practically, a breach of faith with them.

IV.

The argument advanced by the Commissioner, besides being opposed to his own long-continued administrative construction under several reenactments of similar provisions of law, has been rejected by the Board of Tax Appeals and the federal courts.

It seems hardly necessary to deal in detail with the argument advanced by the Commissioner, in view of the fact that such argument is directly opposed to the Commissioner's own long-continued administrative construction of the law under several reenactments of similar provisions of the statute, and in view of the fact that such argument has been rejected by the United States Board of Tax Appeals and all the federal courts which have dealt with the subject.

It does not seem unfair, however, to point out that the Commissioner is obviously hard driven for support when he finds it necessary to advance, as indicative of the legislative intent of the statute, the language used by a private citizen before a Congressional committee in the first stages of a bill which was much changed in the course of its passage through Congress, even if that language could be distorted to support the Commissioner (Petitioner's brief, *Bliss* case, p. 13). It is scarcely to be believed that the reasonable intent of the statute, which seems plain from the language used, and which has

received the Commissioner's own administrative construction, approved by Congress by virtue of several reenactments of similar provisions of law, is now recently discovered by the Commissioner to be altogether different from what he had formerly held it to be, and that such intent is to be derived from the language used by a private citizen in informal discussion with committees of Congress. But, even if recourse be had to that discussion, or to the discussion of Dr. Adams with Senator Smoot, to which the Commissioner refers, there is nothing shown which is contrary to the Commissioner's former position and the respondent's present position. Those discussions simply show that the object was, as we have pointed out, page 13, *ante*, to afford a different rate of tax on capital gains for the purpose of stimulating, to the advantage of the Treasury, taxable sales of capital assets.

The *Westfeldt* case, referred to in the Commissioner's brief, did not at all involve the question of the computation of "net income" for the purpose of determining the amount of deduction allowable for contributions, and it illustrates nothing more than that the capital gains and capital net loss provisions simply affect the rate of taxation, as does the amount of dividends or the amount of a taxpayer's earned income.

The decision of the Board of Tax Appeals in *Elkins* v. *Commissioner*, 24 B. T. A. 572, was followed in *Harbison* v. *Commissioner*, 26 B. T. A. 896; *Bliss* v. *Commissioner*, 27 B. T. A. 205; and *Colgate* v. *Commissioner*, 27 B. T. A. 506, in opinions by individual members of the Board and without review by the entire Board of sixteen members. When the question came to be reconsidered in *Straus* v. *Commissioner*, 27 B. T. A. 1116 (April 6, 1933), it was reviewed by the entire Board which held in accordance with the Commissioner's administrative construction and the respondent's argument herein, and declared that its prior decisions on the

question were in error and would no longer be followed. The Board's decision in the *Straus* case was followed in its opinion in this case (R. 17), and has been followed in all cases since decided involving the same question. The opinions in those cases were by memorandum and have not been published, but may be found in the following Board proceedings: *Woodward* v. *Commissioner*, Docket No. 65517 (April 10, 1933); *Robinette* v. *Commissioner*, Docket No. 53905 (April 10, 1933); *Watkin* v. *Commissioner*, Docket No. 65513 (May 10, 1933); *Igleheart* v. *Commissioner*, Docket No. 45571 (September 20, 1933); *Poor* v. *Commissioner*, Docket No. 58186 (January 22, 1934); *Watts* v. *Commissioner*, Docket No. 66111 (February 2, 1934).

The *Bliss*, *Harbison* and *Colgate* cases were appealed to the Circuit Court of Appeals for the Second Circuit. The Commissioner there advanced the same arguments he advances here. They were rejected. See the opinion of the Court, by Judge Swan, in the case of *Bliss* v. *Commissioner* 68 Fed. (2d) 890.

The opinion in the Bliss case completely disposes of the argument advanced by the Commissioner. It is interesting to note that Judge Swan points out that the Government argued before his Court in 1928, as the taxpayer argues here, that the capital gains provisions related merely to rates and did not affect the computation of the allowance of charitable deductions.

In addition to the opinion of the Second Circuit, the United States District Court for the Northern District of Illinois, in the case of *George Waller Blow and Wayne Chatfield-Taylor, as Administrators* v. *United States*, decided September, 1933, not reported in Federal Reports but to be found in 1933 C. C. H. para. 9507, and the United States Circuit Court of Appeals for the First Circuit, in the case of *White* v. *Atkins, Collector*, 69 Fed. (2d) 960, affirming *Atkins* v. *White*, 3 Fed. Supp. 694,

have rejected the arguments here advanced by the Commissioner and have held in favor of the contentions made by the respondent.

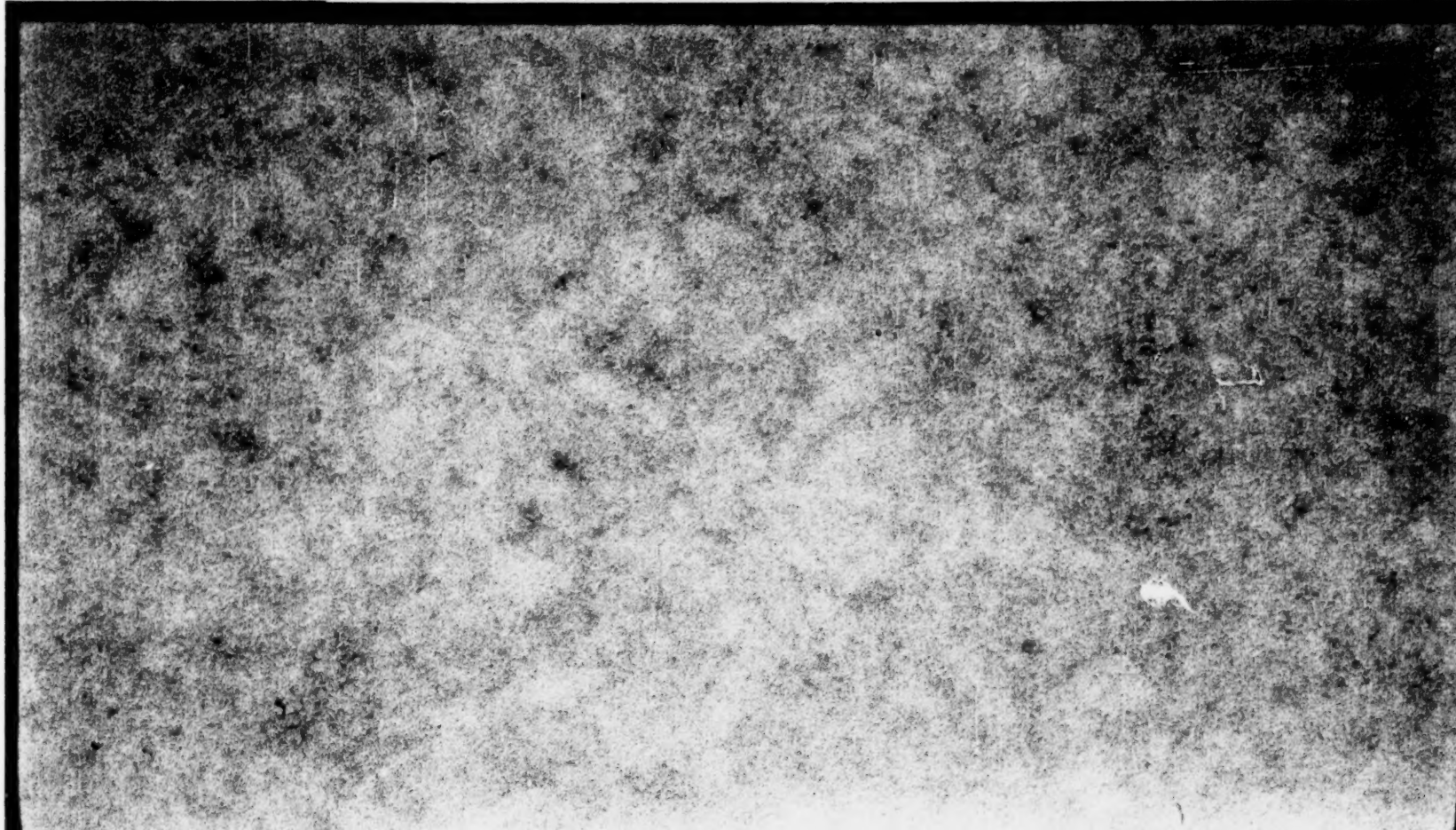
In short, in all tribunals where the matter has been decided the Government's argument has been rejected.

CONCLUSION.

It is submitted that the statutory definition of the term "net income" is clear and unambiguous and requires no strained interpretation; that if any construction or interpretation is required, the construction here advanced by the respondent, and consistently advanced by the Commissioner under several reenactments of similar provisions of the statute, is the proper construction; that the position advanced by the Commissioner herein would work obvious absurdities and injustices and defeat the benevolent purposes of the statutory provision allowing deductions for charitable contributions; that the decisions of the United States Board of Tax Appeals in this case and of the federal courts in similar cases, all in harmony with the Commissioner's own previous position, are correct; and that the Commissioner's argument herein should be rejected and the judgment of the Circuit Court of Appeals affirmed.

Respectfully submitted,

JAMES E. MACCLOSKEY, JR.,
HUGH SATTERLEE,
Attorneys for the Respondent.



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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934

NO. 6

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

vs.

SUSAN DWIGHT BLISS

BRIEF AS AMICUS CURIAE ON BEHALF OF AARON STRAUS

FREDERICK SCHWERTNER,
Counsel for Aaron Straus,
1000 National Press Building,
Washington, D. C.

UNITED PUBLISHING COMPANY INC., 717 SIXTH ST. N. W., WASHINGTON, D. C.

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SUSAN DWIGHT BLISS

BRIEF AS AMICUS CURIAE ON BEHALF OF AARON STRAUS

I.

Preliminary Statement

Aaron Straus is the appellee in the case of *Guy T. Helvering, Commissioner of Internal Revenue, Appellant v. Aaron Straus*, 27 B.T.A. 1116, which is pending after argument before the Court of Appeals of the District of Columbia on the appellant's petition for review.

The issue in the *Straus* case is similar to that in the *Bliss* case and involves a construction of Section 23 (n) of the Revenue Act of 1928, which provides that in

computing net income contributions to charitable institutions shall be allowed as deductions from gross income to an amount which does not exceed 15 per centum of the taxpayer's "net income," as computed before any allowance for contributions.

Aaron Straus in the year 1929 had a total net income of $809,543.86, consisting of "ordinary net income," of $43,079.90, before any allowance for contributions, and a "capital gain" of $766,463.96, before any allowance for contributions. There were no items of capital loss or capital deductions for the year 1929.

Aaron Straus donated to charitable institutions in the year 1929 the sum of $144,695.04. The Commissioner of Internal Revenue only allowed as a deduction for such contributions the sum of $6,461.99, under his theory which was first adopted in the year 1932 that when a taxpayer has a "capital net gain," and elects to be taxed thereon at 12½ per cent, the deduction for charitable contributions is confined to 15 per cent of his "ordinary net income."

In a unanimous opinion by the full Board, it was held that Aaron Straus was entitled to a deduction of $121,431.78 for charitable contributions, such sum being 15 per cent of his total net income, before any allowance for contributions.

II.

Questions Involved

The questions involved are simple: What is the meaning of the term "net income," as used in Section

23 (n) of the Revenue Act of 1928? Does the net income from the sale of investment property held more than two years, denominated a "capital net gain," by Section 101 (c) (5) of the 1928 Act, form a part of "net income," as that term is used in Section 23 (n)? Did Congress by the adoption of the capital gain provisions intend to invade Section 23 (n) with the result that a taxpayer's deduction for charitable contributions is either impaired or wholly destroyed?

It was the uniform administrative practice of the Commissioner of Internal Revenue to allow charitable contributions as deductions to the limit of 15 per cent of a taxpayer's total net income, including capital net gain, from 1921, when the capital gain provisions were originally adopted, to 1932, when he reversed his position.

III.

The Facts

The *Bliss* case involves the years 1928 and 1929, and the issue as to the amount allowable as a deduction for charitable contributions is common to both taxable years. It will suffice, therefore, to state the facts with reference to the year 1928 only. During that year, the taxpayer made charitable contributions in the amount of $43,995.92. Her "ordinary net income," for the year 1928 before the deduction of the amount of such contributions was $270,490.77, and her "capital net gain" was $211,544.82. The Commissioner of Internal Revenue allowed as a deduction for charitable contributions the sum of $40,573.62, being 15 per cent of her "ordinary net income," as computed before the

deduction for charitable contributions, and disallowed as a deduction the balance of $3,422.30.

The destructive effect of the Commissioner's construction of the term "net income," as used in Section 23 (n) of the 1928 Act to mean "ordinary net income," when a "capital net gain" is present is more glaringly patent in the *Straus* case. In the *Straus* case, the taxpayer is entitled to a deduction for charitable contributions in the sum of $121,431.78 if his total net income is used as a measuring rod. The Commissioner, however, only allowed the sum of $6,461.99, which is less than 1 per cent of the taxpayer's total net income, and disallowed as a deduction the balance of $114,969.79.

IV.

The Statute

The pertinent portions of the Revenue Act of 1928 are as follows:

TITLE I—INCOME TAX

Sec. 23. Deductions from Gross Income

In computing net income there shall be allowed as deductions:

Section 23 (n) Charitable and Other contributions. In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

(1) the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(3) the special fund for vocational rehabilitation authorized by Section 7 of the Vocational Rehabilitation Act;

(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts, or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) a fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals;

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules

and regulations prescribed by the Commissioner, with the approval of the Secretary. (For unlimited deduction if contributions and gifts exceed 90 per centum of the net income, see Section 120.) (Italics supplied.)

PART II—COMPUTATION OF NET INCOME

Sec. 21. Net Income

"Net income" means the gross income computed under Section 22, less the deductions allowed by Section 23.

Sec. 22. Gross Income

(a) General definition. "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, *or sales, or dealings in property,* whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. (Italics supplied.) * * *

(e) Determination of Gain or Loss. In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in Sections 111, 112, and 113.

Sec. 23. Deductions from Gross Income

In computing net income there shall be allowed as deductions:

(a) Expenses. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

(b) Interest. All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

(c) Taxes Generally. Taxes paid or accrued within the taxable year, except—

(1) Income, war-profits, and excess-profits taxes imposed by the authority of the United States;

(2) so much of the income, war-profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States as is allowed as a credit against the tax under section 131; and

(3) taxes assessed against local benefits of a kind tending to increase the value of the prop-

erty assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

For the purpose of this subsection, estate, inheritance, legacy, and succession taxes accrue on the due date thereof, except as otherwise provided by the law of the jurisdiction imposing such taxes, and shall be allowed as a deduction only to the estate. * * *

(d) Taxes of Shareholders Paid by Corporation. * * *

(e) Losses by Individuals. In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft.

(f) Losses by corporations. * * *; (g) Basis for determining loss * * *; (h) Loss on sale of stock or securities * * *; (i) Net Losses * * *; (j) Bad debts * * *; (k) Depreciation * * *; (1) Depletion * * *; (m) Basis for depreciation and depletion * * *; (n) Charitable and other

contributions * * *; (o) Future expenses in case of casual sales of real property * * *; (p) Dividends received by corporations * * *; (q) Pension trusts * * * .

SUBTITLE C—SUPPLEMENTAL PROVISIONS

Supplement A—Rates of Tax

(Supplementary to Subtitle B, Part I)

Sec. 101. Capital Net Gains and Losses

(a) Tax in Case of Capital Net Gain. In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) Tax in Case of Capital Net Loss. In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows; a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax

shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) Definitions. For the purpose of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchange during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by Section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. For the purposes of this definition— * * *

(d) Collection and Payment of Tax. The total tax determined under subsection (a) or (b) shall be collected and paid in the same manner, at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

V.

ARGUMENT

A

THE COURTS HAVE CONSISTENTLY HELD THAT THE 15 PER CENT LIMITATION ON THE DEDUCTION FOR CHARITABLE CONTRIBUTIONS IS TO BE MEASURED BY A TAXPAYER'S TOTAL NET INCOME, INCLUDING CAPITAL NET GAIN.

The unanimous opinion of the full Board in the *Straus* case served to repudiate and overrule the deci-

sions of individual members in *Ralph W. Harbison*, 26 B.T.A. 896, *Susan Dwight Bliss*, 27 B.T.A. 205 and *Mary Colgate*, 27 B.T.A. 506. The views expressed by the full Board in the *Straus* case have been adopted by the Courts in an unbroken line of decisions.

Bliss v. *Commissioner of Internal Revenue*, (C.C.A. 2), Jan. 8, 1934, 68 F. (2d) 890;
White, Collector of Internal Revenue v. *Atkins*, (C.C.A. 1), Mar. 14, 1934, 69 F. (2d) 960;
Blow et al. v *U. S.* (N.D. Ill.) Sept. 21, 1933, 5 F. Supp. 737.

The Board has also followed its decision in the *Straus* case in *Robinette* v. *Commissioner*, 27 B.T.A. 1426, *Igleheart* v. *Commissioner*, 27 B.T.A. 1426, *Woodward* v. *Commissioner*, 27 B.T.A. 1426, decided by unpublished memoranda opinions, *Augusta Bliss Reese*, decided March 6, 1934, 30 B.T.A. —, and *Irving Fisher*, decided April 20, 1934, 30 B.T.A. —.

There is no federal court decision in any jurisdiction which supports the respondent in his contention that capital gain should be excluded from net income in determining the 15% deduction for charitable contributions.

Although necessarily classed as *obiter dicta*, it was definitely recognized by the Circuit Court of Appeals for the Second Circuit in *Sadowsky* v. *Anderson*, 29 F. (2d) 677, decided December 10, 1928, affirming 25 F. (2d) 1014, certiorari denied 49 S. Ct. 346, 279 U. S. 849, 73 L. Ed. 992 that the 15% deduction for charitable contributions was not affected by the capital gain provisions of the Revenue Act of 1921 (substan-

tially reenacted in the Revenue Act of 1928). In that case the taxpayer was the owner of a clothing business which he incorporated on June 6, 1919. He had other sources of income. With respect to the income of the business, he chose to be taxed for the year 1918 and that portion of the year 1919 prior to incorporation as if the income were that of a corporation. This was permitted by Section 330 of the Revenue Act of 1918. The question was whether the deduction for charitable contributions was limited in amount of 15% of his net income, *including* or *excluding* that part of his income which was computed and taxed as corporate income pursuant to Section 330. The Commissioner of Internal Revenue refused to allow any deduction for charitable contributions based on business income, because no such deduction was allowed corporations in computing their net income under the Revenue Act of 1918.

The Court decided in the Commissioner's favor, denying the deduction on business income which was computed and taxed as that of a corporation, but the following language in the opinion of Judge Augustus N. Hand indicates the distinction which, applied to the *Bliss* case, would result in granting the deduction based upon net income inclusive of capital gain (p. 678):

> "The fact that the allowance of charitable gifts was not cut off where income of individuals derived from capital gains was taxed at special rates under Section 206 of the Revenue Act of 1921 (42 Stat. 232), and that it was similarly available where dividends of prior years were received in 1917, or subsequent years, but taxed at prior years' rates cannot extend the deduction

> to income derived from plaintiff's clothing business. The option in those cases related merely to rates, and was accompanied by no language providing for the 'computation' of the income as that of a corporation."

In view of the fact that the Government is now on the other side of the fence and is contending that the capital gain provisions *do* cut down on the charitable contributions, it is interesting to note the following excerpt beginning on page 9 of the Government's brief in the *Sadowsky* case:

> "4. That the plaintiff loses sight of the fact that the income which is taxed at corporate rates is not the income of the individual strictly, but the income of trade or business treated as a corporation, is apparent by the supposed analogies which he offers in support of his conclusion. Both instances cited by him (*capital gain provisions and prior year dividends received in 1917) were cases of options to the taxpayer as to what rate was to be paid upon part of his income. They did not, as here, affect the method of computing net income, nor did they deal with splitting an individual into two distinct legal personalties. In each instance, the net income was computed in accordance with the provisions of the statute dealing with an individual. It lay with the taxpayer to decide whether as to part of his income one rate or the other would apply, but the whole income was measured and determined by the provisions relating to individuals. Here the net income from the business is as separate and distinct from the net income from other sources of the individual to the same extent as though the business had in fact been incorporated and the plaintiff were its

*MY INSERTION.

sole strockholder. *In the two instances cited, therefore, there was every reason why the taxpayer should be allowed a deduction up to 15% of his income on account of his charitable contributions, for the option there was an option merely as to rates, not as to the determination of the amount of net income.*" (Italics supplied.)

B

CONGRESS BY ADOPTING SECTION 23 (n) PLAINLY EVINCED A LEGISLATIVE POLICY TO ENCOURAGE CHARITABLE CONTRIBUTIONS, AND THIS POLICY WAS NOT REVERSED IN 1921 WHEN THE CAPITAL GAIN PROVISIONS WERE ENACTED.

The provision permitting a deduction from gross income of charitable contributions to the extent of 15 per cent of the net income computed without the benefit of this deduction was originally introduced by the Revenue Act of 1917 upon the advent of high taxes in this country. Section 1201 (2) of the Revenue Act of 1917, amending the Act of 1916, provided that charitable contributions may be deducted "to an amount not in excess of fifteen per centum of the taxpayer's taxable net income as computed without the benefit of this paragraph." Its obvious purpose was to encourage gifts for charity, education and science. Congressional Record, September 7, 1917, p. 6728. It has been continued in substantially the same form in each successive revenue act, the Revenue Acts of 1918, 1921, 1924, 1926, 1928, 1932 and 1934.

In furtherance of the policy to encourage charitable gifts, Congress also provided that for Federal estate tax purposes the amount of all bequests to charitable institutions shall be deducted from the value of the

gross estate. The purpose of the enactment of this particular legislation was well recognized in *U. S.* v *Provident Trust Company*, 78 L.ed. 510, 514, decided February 5, 1934, wherein this Court, speaking through Mr. Justice Sutherland, made the following pertinent observation:

> "We have for consideration simply a statutory provision exempting from a prescribed tax the value of all bequests, etc., made to or for the use of charitable organizations and those which are akin, plainly evincing a legislative policy to encourage such bequests. Edwards v. Slocum, 264 U. S. 61, 63, 68 L. ed. 564, 565, 44 S.Ct. 293. And, in that view, we may well assume that Congress could not have meant to leave its aim to be diverted by a purely arbitrary presumption, which whether applicable or not to sustain another or different policy, would deny the truth and subvert the policy of this particular legislation. Compare Humes v. United States, supra (276 U. S. at p. 494, 72 L. ed. 670, 48 S.Ct. 347)."

When the capital gain provisions were adopted in 1921, it clearly was not within the mind of Congress that the same would clash with the provisions permitting a deduction for charitable contributions to the extent of 15 per cent of a taxpayer's net income. It was not the aim of Congress by the adoption of the capital gain provisions to in any manner impair or wholly destroy the deduction for charitable contributions. The amount allowable as a deduction for charitable contributions is governed by Section 23 (n), and not by Section 101 which contains the capital gain provisions. When the Commissioner seeks to read into Section 23 (n) a further limitation so as to confine the deduction to 15 per cent of a taxpayer's ordi-

nary net income where part of his net income consists of a capital net gain, he clearly is usurping a legislative function beyond his power. Such a position tends to thwart or defeat the policy of Congress to encourage charitable contributions, and produces incongruous results inconsistent with the legislative purpose.

To illustrate the inequitable operation of the statute under the Government's present view, assume three taxpayers made charitable contributions of $30,000 each and had respective incomes as follows:

	A	B	C
Gain (or loss) from business.....	($100,000)	$100,000	$200,000
Gain from sale of capital assets...	300,000	100,000	None
Net income (before a deduction for contributions)	$200,000	$200,000	$200,000

In accordance with the provisions of Section 23 (n) and the statutory definition of "net income," which is conclusive, there is an allowable deduction for contributions, within the limitation, of $30,000 in each of the above cases. However, following the Government's theory, the deduction is determined not by the question of the *amount* of net income, exclusive of a deduction for contributions, but by the kind of net income realized. Under that view, A would be allowed a deduction for contributions of zero, B a deduction of $15,000 and C a deduction of $30,000, despite the fact that each has the same statutory net income.

It is not to be presumed, without clear legislative pronouncement to the contrary, that taxpayers having the same economic and statutory net income are to be treated so differently.

Congress in enacting the capital gain provisions in 1921 sought to stimulate the conversion of capital investments, and to remove the deterrent effect of high surtax rates on such transactions. Under the Revenue Act of 1921, the surtax rates ranged from 1% to 65% on incomes in excess of $5,000.00. Congress was undoubtedly convinced that the high rates of tax retarded sales of investment property with a consequent loss of revenue to the Government. In remedying this situation by the adoption of the capital gain provisions, Congress envinced no purpose to subvert its policy to encourage contributions to charitable organizations. The two policies are entirely unrelated, and both of them may be effectually accomplished by a reasonable and sensible construction of the statue.

The legislative purpose of the enactment of the capital gain provisions was well stated by Mr. Justice Stone, who delivered the opinion of the Supreme Court of the United States in *Burnet* v. *Harmel*, decided November 7, 1932, 287 U. S. 103,106, as follows:

> "Before the Act of 1921, gains realized from the sale of property were taxed at the same rates as other income, with the result that capital gains, often accruing over long periods of time, were taxed in the year of realization at the high rates resulting from their inclusion in the higher surtax brackets. The provisions of the 1921 revenue act for taxing capital gains at a lower rate, reenacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such

> conversions. House Report No. 350, Ways and Means Committee, 67th Cong., 1st Sess. on the Revenue Bill of 1921, p. 10; see Alexander v. King (C. C. A. 10th) 74 A. L. R. 174, 46 F. (2d) 235."

The legislative reasons for the adoption of the capital gain provisions were also adverted to by Mr. Justice Butler in *Helvering* v. *New York Trust Co.*, 78 L. ed. 960, 964, 54 S. Ct. 806, 809, decided May 28, 1934.

In Report No. 275, 67th Cong., 1st Sess., Senate Finance Committee, covering the Revenue Bill of 1921, which for the first time introduced the capital gain provisions, it is stated on the subject of deductions:

> "Section 214 allows substantially the same deductions in computing net income as are allowed under existing law * * *."

The Revenue Act of 1918 authorized a deduction for charitable contributions to an amount not in excess of 15% of the taxpayer's net income.

In the absence of any expression of legislative intent to employ the capital gain provisions to cut down the allowable deduction for charitable contributions or to change the meaning of the term "net income," we must presume that the plain meaning of Sections 21, 22 and 23 of the Revenue Act of 1928 has not been abrogated.

When Congress makes a change in an existing revenue act, it is the well established policy of the

House Ways and Means Committee and the Senate Finance Committee to explain the nature of the change in their reports. When Congress proposed the adoption of the capital gain provisions, the Senate Finance Committee expressly stated in its report covering the Revenue Bill of 1921 that the allowable deductions are substantially the same as under existing law. If Congress had any intention of impairing or destroying the 15% deduction for charitable contributions when a taxpayer elected to be taxed on his capital gain at 12½%, it would have used appropriate language in the act to effectuate such a purpose.

Congress not only used the term "net income", in Section 23 (n) of the Revenue Act of 1928 providing for the 15% limitation on the deduction for charitable contributions, but also employed the same term in Section 120, allowing an unlimited deduction for charitable contributions where the taxpayer in the taxable year and ten preceding taxable years made contributions in excess of 90 per cent of his net income, including taxes paid, and in Section 706 providing for a limited deduction for charitable contributions to a trust in the year 1923. If the term "net income", as used in Sections 120 and 706 were construed to mean net income, excluding capital gains, it would obviously do violence to the plain legislative purpose of the enactment of these sections.

In Report No. 398, 68th Cong., 1st Sess., Senate Finance Committee, covering the Revenue Act of 1924, it is stated on the subject of the unlimited de-

duction for charitable contributions (at p. 24) as follows:

> "Section 214 (a) (2) * * * The paragraph has been further amended to provide that the limitation upon the amount of deductions allowable under this paragraph to 15 per cent of the taxpayer's net income shall not be applied, if the taxpayer has for each of the 10 preceding years, as well as the year in question, contributed an amount equal to or exceeding 90 per cent of his income to the organizations and for the purposes specified in this paragraph. This provision is designed substantially to free from income taxation one who is habitually contributing to benevolent organizations amounts equalling virtualy his entire income."

Congress, instead of evincing an intent or purpose to impair or destroy the deduction for charitable contributions, has manifested a policy of liberality towards benevolently inclined taxpayers.

Congress in the use of the term "net income", in Sections 23 (n), 120 and 706 of the Revenue Act of 1928 obviously meant net income subject to tax, including capital gains.

C

THE TERM "NET INCOME," AS USED IN SECTION 23 (n) MEANS THE NET INCOME AS DEFINED BY SECTIONS 21, 22 AND 23 AND INCLUDES A CAPITAL NET GAIN.

The "net income", which is subject to tax under the Revenue Act is a statutory concept. Section 21

of the Revenue Act of 1928 defines "net income", as the gross income computed under Section 22, less the deductions allowed by Section 23. Section 22 (a) expressly provides that "gross income", includes the gain derived from sales or dealings in property, whether real or personal, and therefore no taxpayer can hope to escape taxation of a capital gain by contending that it falls without the purview of Section 22 (a). Section 22 (e) expressly covers the computation of the taxable gain in the case of a sale or other disposition of property.

The computation of net income is made under Sections 21, 22 and 23 of the Revenue Act of 1928, and not under the capital gain provisions.

The Treasury Regulations from 1921 to 1932 have recognized that income derived from the sale of capital assets is part of the statutory net income. In Treasury Regulations 74 under the Revenue Act of 1928, it is stated (at p. 8):

> "Art. 41. Meaning of net income. The tax imposed by the Act is upon the income. In the computation of the tax various classes of income must be considered:
>
> "(a) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes in the forms of income specifically described as gains and profits, *including gains derived from the sale or other disposition of capital assets.* * * * " (Italics supplied.)

Article 21 of Regulations 62 under the 1921 Act, Article 21 of Regulations 65 under the 1924 Act, and Article 21 of Regulations 69 under the 1926 Act contain identical language on this subject.

A capital gain also falls within the general and accepted definition of income for taxation purposes which the Supreme Court held to be "the gain derived from capital, from labor, or from both combined."

> *Eisner* v. *Macomber*, 252 U. S. 189, 40 S. Ct. 189, 193, 64 L. Ed. 521, 9 A. L. R. 1570;
>
> *Merchants' Loan & Trust Co., Tr* v. *Smietanka*, 225 U. S. 509, 517, 41 S. Ct. 386, 65 L. Ed. 751, 15 A. L. R. 1305.

See also *American Can Co.* v. *Bowers*, 35 F. (2d) 832, 834, certiorari denied, 281 U. S. 736, wherein it is stated:

> "Necessarily, net income, for tax purposes is a conception of the income tax statute, and the amount arrived at is ascertained by deducting from the gross amount of income received by the taxpayer from all sources the specified deductions allowed to it by statute."

D

IT WAS THE ADMINISTRATIVE PRACTICE OF THE COMMISSIONER FROM 1921 TO 1932 TO ALLOW AS A DEDUCTION CHARITABLE CONTRIBUTIONS UP TO 15 PER CENT OF A TAXPAYER'S TOTAL NET INCOME, INCLUDING CAPITAL NET GAIN.

As has been previously stated, all of the revenue acts from 1917 to 1934 on the question involved limited the

deduction for charitable contributions to an amount not in excess of 15% of the taxpayer's net income before any allowance for contributions. The Government now maintains that the introduction of the capital gain provisions commencing with the Revenue Act of 1921 carried with it an exclusion of such gain from net income in computing the 15% deduction for charitable contributions, so that the administrative practice of allowing a deduction to the extent of 15% of a taxpayer's net income under the Revenue Acts of 1917 and 1918 is not decisive.

However, this administrative practice of the Commissioner of Internal Revenue to allow a deduction for contributions to the extent of 15% of a taxpayer's net income, including capital gains, continued throughout the Revenue Act of 1921, 1924, 1926 and 1928, all of which acts contained capital gain provisions in substantially the same language, down to January 27, 1932, when the Commissioner promulgated Mim. 3931, Internal Revenue Bulletin XI-7, p. 2, of February 15, 1932, Cumulative Bulletin XI-1, p. 33. This mimeograph was issued after the decision of the Board of Tax Appeals in *Hallie D. Elkins*, 24 B. T. A. 572, (decided November 3, 1931), which involved the determination of the deduction for charitable contributions where the taxpayer sustained a capital net loss, a problem unlike the present one, and it was therein provided that pending final court decision in the *Elkins* case, capital net gains are to be excluded in the audit of returns for 1929 and subsequent years in arriving at the net income subject to the 15% limitation in ascretaining the deduction for charitable contributions. The capital net loss provisions first appeared in the Revenue Act of 1924.

The Government, however, never prosecuted an appeal from the decision of the Board in the *Elkins* case, supra, and there is no case pending in court involving the amount allowable as a deduction for charitable contributions where the taxpayer sustained a capital net loss, as far as this counsel is informed.

In Prentice-Hall Federal Tax Service for 1932, page 14905, par. 14910, it is stated:

> "Fifteen per cent limitation for deductions account charitable contributions applies to total net income inclusive of gain from sale of capital assets. (Telegram to A. B. Trudgian, New York, signed E. W. Chatterton, Deputy Commissioner, dated February 6, 1923)."

This decision was promulgated under the Revenue Act of 1921, which contained capital gain provisions substantially the same as appear in the 1928 Act. This decision was consistently followed by the Bureau of Internal Revenue until the issuance of Mimeograph 3931 referred to above, all of which accounts for the absence of any prior final court decision on the subject involved.

In *Ralph W. Harbison*, 26 B. T. A. 896 (decided August 29, 1932), *Susan Dwight Bliss*, 27 B. T. A. 205 (decided December 2, 1932 and *Mary Colgate*, 27 B. T. A. 506 (decided December 30, 1932), the Commissioner of Internal Revenue had allowed in his notices of deficiencies in tax a deduction for charitable contributions based on 15% of the taxpayers' total net income, including capital gains. The taxpayers appealed to the Board on other issues, and the Commissioner

in his answer, after changing his position on the 15% deduction for contributions where part of the net income consists of a capital gain, claimed an increased deficiency on the theory that the 15% deduction was limited to 15% of net income, excluding capital gains. Under Section 272 (e) of the Revenue Act of 1928, if an appeal is filed by a taxpayer with the Board, the Commissioner in his answer may claim a deficiency in tax greater than that asserted in his deficiency notice.

In the issuance of the notices of deficiencies in tax in the *Harbison*, *Bliss* and *Colgate* cases, supra, the Commissioner adhered to his long-continued administrative practice of allowing a deduction for contributions to the extent of 15% of a taxpayer's total net income, including capital net gain.

The decisions in these cases which upheld the Commissioner were written by three of the sixteen members of the Board, and were subsequently repudiated by the decision in the *Straus* case, which was decided by the full Board in a unanimous opinion.

It was never contemplated by the Treasury Regulations that if a taxpayer enjoyed a capital net gain, his deduction for charitable contributions should be confined to 15% of his ordinary net income.

In Article 251 of Regulations 62 under the Revenue Act of 1921, it is provided in part as follows:

> "Art. 251. Charitable contributions.—Contributions or gifts within the taxable year are deductible to an aggregate amount not in excess of 15% of the taxpayer's net income, including such payments, * * *."

The same language was repeated in Article 251 of Regulations 65 under the 1924 Act, Article 251 of Regulations 69 under the 1926 Act, Article 261 of Regulations 74 under the 1928 Act, and Article 261 of Regulations 77 under the 1932 Act. There is no language in the regulations which purports to confine the 15 per cent limitation to ordinary net income where part of the net income consists of a capital net gain.

This is clearly a case where the long-continued and uniform departmental construction of the law should be held controlling. Both the law and the regulations provided that gains derived from the sale of capital assets formed a part of net income subject to tax. In the face of this administrative practice, Congress reenacted the capital gain provisions in essentially the same form by the Acts of 1924, 1926 and 1928. Congress has never at any time disapproved the administrative practice of permitting a deduction for charitable contributions to the extent of 15% of a taxpayer's total net income subject to tax, including capital net gains. The deduction for charitable contributions served as an inducement to taxpayers to donate to charity, and many philanthropically minded taxpayers contributed to charitable institutions subsequent to the enactment of the Revenue Act of 1921 large sums in excess of 15% of their ordinary net income. They have parted with their money in reliance of the law and the administrative practice thereunder. It was the purpose of Congress to free from taxation contributions up to 15% of a taxpayer's total net income. Congress was not interested in the characterization of the net income under the Act. The net income from investment property held more than two years and taxed at 12½% was denominated a capital net

gain, but it nevertheless formed a part of a taxpayer's taxable net income under the Act.

It is fair to assume that if the departmental interpretation which was a long-continued and consistent one did not properly reflect the meaning and intent of Congress, that body would have challenged and corrected such holding instead of continually reenacting the capital gain and charitable contribution sections in their existing language. Having refrained from making any change in the provisions affecting the deduction for charitable contributions, it must be presumed that Congress was content with the Commissioner's administrative interpretation. This principle of law has been consistently adhered to by the Supreme Court of the United States in a long line of cases:

U. S. v. *Dakota-Montana Oil Co.*, 288 U. S. 459;

McCaughn v. *Hershey Chocolate Co.*, 283 U. S. 488, 492;

Poe v. *Seaborn*, 282 U. S. 101, 117;

Universal Battery Co. v. *U. S.*, 281 U. S. 580;

Brewster v. *Gage*, 280 U. S. 327, 337;

National Lead Co. v. *U. S.*, 252 U. S. 140;

Latimer v. *U. S.*, 223 U. S. 501, 504;

U. S. v. *Baruch*, 223 U. S. 191, 199;

Komada & Co. v. *U. S.*, 215 *U. S.* 392, 396;

U. S. v. *Cerecedo Hermanos y Compania*, 209 U. S. 337, 339;

Copper Queen Mining Co. v. *Arizona Board*, 206 U. S. 474, 479;

U. S. v. *Falk and Bro.*, 204 U. S. 143, 152;

N. Y., N. H. & H. R. R. Co. v. *I. C. C.*, 200 U. S. 361, 401;

Robertson v *Downing*, 127 U. S. 613;

U. S. v. *Philbrick*, 120 U. S. 52, 58;

McDonald v. *Hovey*, 110 U. S. 619, 629.

The principle of law enunciated by these cases operates with equal force for the benefit of the taxpayer as well as the Commissioner of Internal Revenue.

The case of *Hallie D. Elkins*, 24 B. T. A. 572, involved the determination of the amount of the deduction for charitable contributions where the taxpayer sustained a capital net loss. In that case, the taxpayer had an ordinary net income of $113,151.98 in the year 1924, exclusive of charitable contributions, and a capital net loss of $127,259.41. The taxpayer made charitable contributions of $8,632.65. Under the Revenue Act of 1924, the ordinary net income was subjected to a tax of $23,766.77, and a credit against this tax was allowed under the Act to the extent of 12½% of the capital net loss. There was no election under the Act where the taxpayer came within the provisions of the capital net loss section. The application of its provisions was mandatory. While in that case, the loss was in excess of the income, nevertheless the taxpayer was required to pay a tax. The Commissioner refused to allow any deduction for charitable contributions, because the taxpayer's loss was in excess of her income.

Trussell, who delivered the opinion of the Board, said (at p. 276) :

> "* * * The reasonable and, in our opinion, the proper interpretation of the applicable sections of the 1924 Act is that when Section 208 (c) is applied, as it must be in this case, the 'ordinary net income' is the basis for determining the amount deductible on account of charitable contributions. * * * It is untenable to say that for the purpose of computing a tax liability this petitioner has a net income of $113,151.98 and that at the same time she has no net income for the purpose of computing the amount allowable as a deduction for contributions."

Apparently the Board adopted a liberal interpretation of the statute in order to avoid an absurd result and to carry out the manifest policy of Congress of aiding charity by allowing a limited deduction for contributions. The problem presented by the *Elkins* case, supra, is unlike the present one. The Government did not prosecute any appeal from the Board's decision in the *Elkins case*, or in any case involving a state of facts similar to those in the *Elkins* case, and it is therefore unnecessary for the Court to pass upon the validity of the decision of the Board in the *Elkins* case. Here, the taxpayer was required to pay a tax on income derived from a capital gain. It would also be untenable to say in this case that the taxpayer must pay a tax on this capital gain, but that it must be excluded from net income in computing the amount allowable as a deduction for contributions.

There is a well established rule that a statute is not to be given an interpretation which will lead to absurd

consequences inconsistent with the legislative purpose.

U. S. v. *Katz*, 271 U. S. 354, 357;

Lau Ow Bew v. *U. S.*, 144 U. S. 47, 59;

Church of Holy Trinity v. *U. S.*, 143 U. S. 457;

U. S. v. *Kirby*, 74 U. S. 482;

Stonega Coke & Coal Co. v. *Commissioner of Internal Revenue*, 57 F. (2nd) 1030, 1031;

In the *Katz* case, supra, Mr. Justice Stone, who delivered the opinion of the Court, made the following observation:

> "All laws are to be given a sensible construction; and a literal application of a statute, which would lead to absurd consequences, should be avoided whenever a reasonable application can be given to it, consistent with the legislative purpose. See Hawaii v. Mankichi, 190 U. S. 197, 212, 47 L. ed. 1016, 1020, 23 Sup. Ct. Rep. 787, 12 Am. Crim. Rep. 465, and cases there cited. In ascertaining that purpose, we may examine the title of the Act (United States v. Fisher, 2 Cranch, 358, 386, 2 L. ed. 304, 313; United States v. Palmer, 3 Wheat. 610, 631, 4 L. ed. 471, 477; Church of the Holy Trinity v. United States, 143 U. S. 457, 462, 36 L. ed. 226, 229, 12 Sup. Ct. Rep. 516), the source in previous legislation of the particular provision in question (United States v. Saunders, 22 Wall. 492, 22 L. ed. 736; Viterbo v. Friedlander, 120 U. S. 707, 30 L. ed. 776, 7 Sup. Ct. Rep. 962; United States v. Morrow, 266 U. S. 531, 535, 69 L. ed. 425, 427, 45 Sup. Ct. Rep. 173), and the legislative scheme or plan by which the general purpose of the act is to be carried out. (See Platt v. Union P. R. Co., 99 U. S. 48, 63, 64, 65, 25 L. ed.

424, 429; Bernier v. Bernier, 147 U. S. 242, 246, 37 L. ed. 152, 154, 13 Sup. Ct. Rep. 244).

In the decision of the instant case, it is not necessary to pass upon the validity of the decision of the Board in the *Elkins* case, supra. While the Commissioner previously acquiesced in the decision in the *Elkins* case, it is his present administrative practice to include the amount of a capital net loss in the computation of net income for the purpose of Section 23 (n), and to disallow any deduction for charitable contributions where the capital net loss is in excess of ordinary net income even though a taxpayer may be required to pay a tax.

In the case of a capital net gain, the amount thereof constitutes the net income derived from the sale of investment property held more than two years and forms a part of net income subject to tax.

In the case of a capital net loss, the amount thereof to the extent of 12½% is allowed as a credit against the normal and surtaxes due on the ordinary net income. The ordinary net income constitutes the net income subject to tax, and against the tax due thereon, there is allowable a credit of 12½% of the capital net loss.

It may be the view of this Court that the net income subject to tax as computed before the deduction for contributions is the basis for determining the 15% limitation on the deduction for charitable contributions and that the statute is not to be given a literal application so that the beneficient purpose of Congress may be effectually accomplished.

The Board in the *Straus* case avoided any expression of opinion as to the soundness of its decision in the *Elkins* case, and merely stated:

> "The cases involving capital net losses may or may not be distinguishable from those involving capital net gains. We express no opinion on that subject, but confine ourselves strictly to the question before us."

On the subject of the deduction for charitable contributions, it is interesting to observe the comments of Robert H. Montgomery in Federal Tax Handbook (1932) at pages 475-476 thereof:

> "Inclusion or Exclusion of Capital Net Gain or Loss for the Purpose of Applying the 15 Per Cent Limitation.—The 15 per cent limitation on the deduction of contributions is based on the statutory 'net income.' 'Net income' as defined by section 21 of the Act means the gross income computed under Section 22, less the deductions allowed by Section 23.
>
> " 'Gross income' as computed under Section 22 includes capital net gain but the deductions listed under Section 23 do not include capital net loss.
>
> "The Treasury formerly permitted the inclusion of capital net gain to arrive at net income for the purpose of computing the limitation (C. B. III-1, 198, I. T. 2013; C. B. III-2, 152, I. T. 2104), and required the deduction from net income of capital net loss for the same purpose. In *Elkins* v. *Com'r* (24 B. T. A. 572) (NA) and *Livingood, Ex'r* v. *Com'r* (25 B. T. A. 585), however, the Board held that capital net losses should not be taken into consideration in computing net income

for purposes of the limitation, inasmuch as capital net losses are not among the list of statutory deductions from gross income in arriving at statutory net income. In view of this decision reversing the established policy of the Treasury, the Treasury issued a ruling (C. B. X. I-7-5386; Mim. 3931) denying the right of taxpayers to include capital net gain in the computation of net income for the purpose of applying the limitation, pending the outcome of its appeal in the *Elkins* case.

"In a decision just promulgated (*Harbison* v. *Com'r*, 26 B. T. A.—, August 29, 1932) the Board of Tax Appeals has taken a similar position to that of the Treasury in Mim. 3931, supra, and has held that in determining the 15 per cent limitation for deduction of contributions the amount of capital net gain should be excluded from ordinary net income.

"The Board's reasoning to justify its position in this case is very weak, holding in effect that when the taxpayer elects to report capital net gain his tax liability is determined in two parts, the capital net gains part not being included in 'net income.' This appears to be an incorrect interpretation of 'net income') (Section 21) and the provisions of Section 23 (n) relating to deductions for contributions, etc."

Since the above was written the three members of the Board who rendered the decisions in the *Harbison*, *Bliss* and *Galeote* cases, supra. reversed themselves by concurring in the unanimous opinion in the *Straus* case, and by following rule announced therein in later cases.

E

THE CAPITAL GAIN PROVISIONS DO NOT SERVE TO IMPAIR OR DESTROY THE DEDUCTION FOR CHARITABLE CONTRIBUTIONS.

The objective of the capital gain provisions was to expedite sales of investment property held by taxpayers for more than two years which had been retarded by the high surtaxes, as was well stated by Mr. Justice Stone in *Burnet* v. *Harmel*, supra, and by Mr. Justice Butler in *Helvering* v. *New York Trust Co.*, supra. In analyzing the capital gain provisions, the intention of Congress and the object sought to be accomplished are important factors.

Congress did not use any language in the capital gain provisions according a flat rate of 12½ per cent on the gain derived from the sale of capital assets to indicate any intent to invade Section 23 (n) governing the deduction for charitable contributions with the effect that the deduction is impaired or wholly destroyed. Congress did not by the adoption of the capital gain provisions of Section 101 intend to ingraft into Section 23 (n) a further limitation limiting the deduction to 15 per cent of a taxpayer's ordinary net income if he had a capital net gain.

Congress in furtherance of the policy to encourage sales of investment property by according an optional rate of 12½ per cent did not intend to subvert another policy to encourage charitable contributions. The two policies are unrelated and both of them can be effectually accomplished by placing upon the statu-

tory provisions a reasonable construction which will serve the plain Congressional purpose. If it had been the purpose of Congress to cut down on the deduction for charitable contributions where a taxpayer had a capital net gain, it would not have hidden its intent in the capital gain provisions, but would have used appropriate language in Section 23 (n) which fixes the limitation on the deduction.

Section 101 does not purport to provide the standards by which net income is computed. "Net income" has been defined by Sections 21, 22 and 23, and is computed under those sections. Section 101 provides an optional rate of tax on a capital net gain, and defines that term. The evident purpose of Congress was to carve out of a taxpayer's total net income his net income from the sale of investment property held more than two years and give him an election to be taxed thereon at 12½ per cent. Congress, instead of envincing an intent in Section 101 to impair or destroy any deduction allowed a taxpayer by Section 23, was careful in its draftsmanship to preserve the same.

Section 101 (c) (5) defines a "capital net gain" to mean the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

All of these terms are defined in Section 101. There is a substantial difference between the meaning of the terms "capital gain," and "capital net gain."

Section 101 (c) (1) defines a "capital gain," to mean taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

Section 101 (c) (8) defines "capital assets," to mean property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business.

Section 101 (c) (3) defines "capital deductions," to mean such deductions as are allowed by Section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

Section (101) (c) (2) defines a "capital loss," to mean a deductible loss resulting from the sale or exchange of capital assets.

Section 101 (c) (4) defines "ordinary deductions," to mean the deductions allowed by Section 23 other than capital losses and capital deductions.

The term "gross income," as used in Section 101 (c) (5) in association with the language "computed without including capital gains," undoubtedly means the "gross income," as defined by Section 22.

No part of the deductions allowed by Section 23 is lost in the process of singling out the amount of the

capital net gain for the purpose of according the same a flat tax of 12½ per cent at the taxpayer's election.

The application of the capital gain provisions may be illustrated by using the figures which are set forth in the opinion in the *Straus* case. It was stipulated in that case that the taxpayer had in the year 1929 a "capital gain," of $766,463.96 as defined by Section 101 (c) of the Revenue Act of 1928, but without any allowance of a deduction for charitable contributions. It was also stipulated that the taxpayer had not items of capital deductions or capital losses. It was also stipulated that the taxpayer had an "ordinary net income," of $43,079.90 as defined by Section 101 (c), but without any allowance of a deduction for contributions as provided by Section 23 (n). The taxpayer had a "gross income computed without including capital gains," of $159,831.87 and the amount of the ordinary deductions without any deduction for contributions was $116,751.97, making the difference of $43,079.90. The taxpayer donated to charitable institutions the sum of $144,695.04, and the Board allowed the sum of $121,431.58, being 15 per cent of the taxpayer's total net income of $809,543.86, consisting of ordinary net income of $43,079.90 and capital gain of $766,463.96, as computed before the deduction for contributioins.

Now, what is the amount of the taxpayer's capital net gain subject to the 12½% tax? Section 101 (c) (5) clearly states that it is the excess of the amount of capital gain over capital deductions and capital losses plus the amount, if any, by which the ordinary

deductions exceed the gross income computing without including capital gains. The amount of the capital gain is $766,463.96 and the taxpayer had no capital deductions or capital losses in the year 1929. However, the ordinary deductions to which the taxpayer was entitled in the year 1929 exceeded the gross income computed without including capital gains. Section 101 (c) (4) defines ordinary deductions to mean the deductions allowed by Section 23 other than capital losses and capital deductions. One of the deductions allowed by Section 23 is for charitable contributions limited only by 15% of the taxpayer's net income. Since the allowable amount for charitable contributions is the sum of $121,431.58, and the taxpayer only had a gross income, computed without including capital gains, of $159,831.87 and the amount of the ordinary deductions without any deductions for contributions was $116,751.97, there was clearly an excess of ordinary deductions over ordinary gross income which under Section 101 (c) (5) was permitted to invade the "capital gain," in arriving at the "capital net gain," subject to the 12½% tax. This is a subject which apparently the Board did not consider in its prior three decisions, but was given effect to in the decision of the *Straus* case.

In Report No. 179, 68th Cong., 1st Sess., Committee on Ways and Means, covering the Revenue Bill of 1924, it is stated at p. 19:

> "Section 208. * * * In the bill paragraph (4) is inserted, and the two succeeding paragraphs are changed in order to revise the definition of capital net gain so that the tax in cases where there is a deficit in ordinary income will be

> 12½% of an amount determined by subtracting from the capital net gain the amount of the deficit in ordinary net income. This provision is in the interest of the taxpayer."

The Board determined that the sum of $688,112.28 represented the amount of the "capital net gain," under Section 101 (c) (5) in the *Straus* case. This was arrived at by subtracting from the "capital gain," of $766,463.96 the amount of $78,351.68, representing the amount by which the "ordinary deductions," exceeded the "gross income computed without including capital gains." Such gross income amounted to $159,831.87 and the ordinary deductions without any deduction for contributions totaled $116,751.97. The Board allowed the sum of $121,431.58 as an "ordinary deduction," for charitable contributions. The ordinary deductions therefore totaled $238,183.55, and exceeded the ordinary gross income by the sum of $78,351.68. There were no items of capital deduction or capital losses in the *Straus* case.

The Revenue Act of 1921 while it taxed specially a capital net gain at 12½%, it failed to expressly provide for an invasion of capital gain where the ordinary deductions exceeded the ordinary gross income.

Congress by the adoption of the capital gain provisions did not expressly or impliedly intend to impair or destroy the deduction for charitable contributions to an amount not in excess of 15% of the taxpayer's net income provided for in Section 23 (n). By a careful study of Section 101 (c), it is found that Congress was careful in preserving to a taxpayer his usual and ordinary deductions and commencing with the Rev-

enue Act of 1924, it was expressly provided that if there was an excess of ordinary deductions over ordinary gross income, such excess was to be subtracted from the amount of capital gain, in arriving at the amount of the capital net gain subject to the 12½% tax.

Section 101 makes no reference to any further limitation on the deduction for charitable contributions contained in Section 23 (n). Section 101 (a) authorizing a 12½% tax on capital net gains must necessarily be read in the light of Section 101 (c) to ascertain if Congress by the adoption of these provisions impliedly intended to cut down the 15% limitation contained in Section 23 (n).

Congress in defining a capital net gain in Section 101 (c) (5) expressly provided that if the ordinary deductions exceeded the gross income computed without including capital gains, the excess was to be dededucted from the amount of the capital gain in determining the capital net gain. We then pass to Section 101 (c) (4) to ascertain if the 15% deduction for contributions is one of the ordinary deductions, and find that "ordinary deductions," means the deductions allowed by Section 23 other than capital losses and capital deductions. Section 23 expressly provides that in computing net income there shall be allowed as a deduction for charitable contributions an amount not to exceed 15% of the taxpayer's net income. It may therefore be said that Congress expressly preserved to a taxpayer as an ordinary deduction his charitable contributions limited only by Section 23 (n). When Congress in Section 101 (c) (7) provided that 'ordi-

nary net income" means the net, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions, it certainly did not intend to exclude the ordinary deduction for charitable contributions not in excess of 15% of a taxpayer's net income. By ordinary rules of grammar, the second clause, "computed in accordance with the provisions of this title," merely explains and identifies what is meant by the expression "net income." "This title," means Title I. Net income computed in accordance with Title I is obviously net income as defined in Section 21 of Title I, i. e., gross income as defined in Section 22 less the deductions allowed by Section 23. In other words, Section 101 (c) (7), where it speaks of net income, means the net income which has been computed in accordance with Sections 21, 22 and 23, but "ordinary net income," means such net income after excluding all items of capital gain, capital loss and capital deductions, that is to say, after excluding capital net gain or capital net loss. The only other possible construction would be to pay no attention to the second comma, between "title" and "after," and attempt to arrive at an anomalous net income by first excluding items of capital gain, capital loss, and capital deductions. That, however, would not be net income and an analysis of the provision can leave no doubt that one must start with net income as computed in accordance with Sections 21, 22 and 23 and then exclude all items of capital gain, capital loss and capital deduction in arriving at ordinary net income.

Section 101 (c) (7) does not in any sense, directly or impliedly, invade Sections 23 (n), 120 or 706 deal-

ing with the deduction for charitable contributions. In order to accomplish effectually the object of Congress in computing a separate rate of tax on capital net gain, Section 101 (c) (7) necessarily had to exclude all items of capital gain, capital loss and capital deductions, but the exclusion of these items does not carry with it an exclusion of the ordinary deduction for charitable contributions. To do so, is to read into Section 101 (c) (7) language which does not appear therein. It would be just as sensible to exclude under Section 101 (c) (7) a deduction for interest at the rate of 6% per annum which a taxpayer may have paid to a bank for a loan to carry capital assets. The only limitation on the deduction for charitable contributions is contained in Section 23 (n) as applied to the instant case, and Congress showed no purpose in the capital gain provisions to impair or destroy this deduction.

As further evidence of the fact that Congress recognized that capital gains were included in gross income as that term is used in Section 22 in computing the net income on which the deduction for contributions is based, reference may again be made to Section 101 (c) (5) which in part provided that in arriving at the capital net gain, "the amount, if any, by which the ordinary deductions exceed the gross income *computed without including capital gains*," was to be substracted from the amount of the capital gain. Why should Congress specify "gross income" *computed without including capital gains*, unless where the term is used without limitation, as in Section 22, "gross income" includes capital gains?

A further clear indication that all items of gross income and deductions that may be found in the statute

are included in Sections 22 and 23, is derived from the fact that Sections 101 (c) (3) and 101 (c) (4) show clearly that the capital deductions and ordinary deductions are, together, those deductions found in Section 23.

Summarizing the question of interpretation, it will be seen that Congress has given a statutory definition to the term "net income" as including all items of gross income less all items of deductions, and necessarily, therefore, the term must include both ordinary net income and capital gain, as is shown conclusively to be true by reference to Section 101 (c) (7) and Sections 168 and 186.

Having defined the terms, the operating provisions of Section 101 present no difficulty. Paragraph 101 (a) provides that in the case of any taxpayer, other than a corporation, who derives a capital net gain, there shall at the election of the taxpayer be paid in lieu of other taxes a tax determined by first computing a partial tax upon the basis of the ordinary net income at the rates and in the manner as if Section 101 had not been enacted, and by regarding the total tax as such amount plus 12½% of the capital net gain. There is no suggestion here of recomputing net income; there is simply a special provision for determining a tax upon net income which includes or comprises capital net gain. There is no more necessity for recomputing net income than there would be where net income includes dividends, or interest on Government bonds. Certainly in view of the fact that Congress in Section 101 (a) provided that a partial tax shall be first computed at the rates and in the manner as if this Section

had not been enacted, there was no intention of disturbing the ordinary deduction for charitable contributions.

It has been suggested that Congress meant to penalize a taxpayer for taking advantage of the tax on capital net gains. No such intention exists in the statute, and the provision for the special taxation of capital net gains was designed at least as much for the benefit of the Government as of the taxpayers, it being intended thereby to stimulate the sales of investment property held by taxpayers more than two years which were retarded by the high surtaxes.

F

IF THE STATUTE IS AT ALL AMBIGUOUS AND A DOUBT EXISTS, SUCH DOUBT IS TO BE RESOLVED AGAINST THE GOVERNMENT.

The Commissioner apparently was not in doubt from 1921 to 1932 that the Act permitted a deduction for charitable contributions to an amount not exceeding 15% of the taxpayer's net income, including capital gains, and it was not until the year 1932 that a doubt existed in his mind as to the propriety of his action. If it can be said that the Act is not clear and is ambibuous on the subject of the deduction for charitable contributions, and a doubt as to its meaning exists, such doubt must be construed most strongly against the Government.

Gould v. *Gould*, 245 U. S. 151;

U. S. v. *Updike*, 281 U. S. 489;

Old Colony R. R. Co. v. *Commissioner of Internal Revenue*, 284 U. S. 552.

Further, the Courts apparently look with favor upon the provisions in the Revenue Acts with respect to charitable contributions and charitable exemptions, because they have given these provisions a liberal construction in order to effectuate the beneficient purpose of Congress.

Lederer v. *Stockton*, 260 U. S. 3;

Benziger v. *U. S.*, 193 U. S. 38, 55;

Andrus et al v. *Burnet*, Commissioner of Internal Revenue, 60 App. D. C. 182, 50 F. (2d) 332.

VI.

CONCLUSION

It is respectfully submitted that the term "net income," as used in Section 23 (n) means total net income subject to tax, as computed before the deduction for contributions, and includes a capital net gain. This is in accordance with the law and the uniform departmental practice from 1921, when the capital gain provisions were originally enacted, to 1932, when the Commissioner reversed his position. Since Congress reenacted the provision governing the deduction for contributions and the section dealing with capital gains in essentially the same language by the Acts of 1924, 1926 and 1928 in the face of this practice, Congress impliedly approved and adopted the administrative construction and this should prevail until changed by legislative action.

Congress by the adoption of the capital gain provisions sought to accomplish the single purpose of stimulating the sale of investment property which was retarded by the high surtaxes, and in effectuating this policy by Section 101, it evinced no purpose to subvert another policy namely that of encouraging contributions to charitable institutions.

A "capital net gain," as computed before the deduction for contributions is simply the net income derived from the sale of investment property held by a taxpayer for more than two years, and forms a part of "net income," as used in Section 23 (n). Such net income was characterized or denominated by Congress as "capital net gain," but it nevertheless constitutes income under the Act as that term is used in Sections 21, 22 and 23 (n).

It is submitted that the Act should be construed in such a manner as will effectually accomplish the beneficient purpose of Congress.

Respectfully submitted,

FREDERICK SCHWERTNER,
Counsel for Aaron Straus,
1000 National Press Building,
Washington, D. C.

August, 1934.

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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 6

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SUSAN DWIGHT BLISS

BRIEF AS AMICUS CURIAE ON BEHALF OF ROBERT TREAT PAINE, 2ND

PHILLIPS KETCHUM,
Counsel for Robert Treat Paine, 2nd.
1 Federal Street,
Boston, Massachusetts.

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B. Even if it might be thought good public policy to exclude *capital net loss* in computing the amount of the charitable deduction, nevertheless it would be most poor public policy and inconsistent with the purpose of the Revenue Act to exclude *capital net gain* in computing the amount of the charitable deduction 9

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I

PRELIMINARY STATEMENT AS TO INTEREST OF ROBERT TREAT PAINE, 2ND

Robert Treat Paine, 2nd, is the claimant in a claim for refund of excessive federal income tax paid by him in the year 1930. This claim for refund was filed by Paine with the Collector of Internal Revenue at Boston on June 14, 1933, and is now pending.

The principal issue in this claim for refund is similar to that in the *Bliss* case and involves a construction of Section 23(*n*) of the Revenue Act of 1928, which provides that, in computing taxable net income, charitable gifts shall be allowed as deductions from gross income to an amount not

in excess of 15 per centum of the taxpayer's "net income," as computed before any allowance for charitable gifts.

In the year 1930 the net income of Robert Treat Paine, 2nd, was made up entirely of capital net gain; the "ordinary deductions" (not including any allowance for charitable gifts) having been in excess of the "ordinary income." In that year Paine made charitable gifts (of a kind deductible under Section 23(*n*) of the Statute) amounting to $8,707.00, which amount was less than 15 per centum of his taxable net income including capital net gain. The Commissioner, in adjustment of Paine's 1930 income tax, disallowed all of said gifts as a deduction, as a result of which disallowance Paine filed claim for refund as aforesaid.

The issue here raised also affects Paine's income tax liability for other years.

II

QUESTION INVOLVED

The question involved is: does the term "net income," as used in said Section 23(*n*) of the Revenue Act of 1928, include net gains from the sale of investment property held for more than two years (*i.e.*, denominated "capital net gains" in Section 101(*c*)(5) of the 1928 Act), or should such capital net gains be excluded in computing said "net income"?

III

THE FACTS

The *Blair* case involves the years 1928 and 1930. The issue as to the amount allowable as a deduction for charitable gifts is common to both taxable years. It will suffice, therefore, to state the facts with reference to the year 1928 only.

During the year 1928 Susan D. Bliss made charitable gifts of $43,995.92. Her total net income in that year (before any allowance for charitable gifts) was $482,035.59, comprised of $270,490.77 "ordinary net income" (before any allowance for charitable gifts) and $211,544.82 "capital net gain" (before any allowance for charitable gifts). The Commissioner of Internal Revenue allowed as a deduction for charitable gifts the sum of $40,573.62, being 15 per centum of her "ordinary net income" (before any allowance for charitable gifts) and disallowed as a deduction the balance of her charitable gifts ($3,422.30). As a result the Commissioner determined a tax deficiency in the year 1928 in the amount of $1,909.31.

On an appeal, the Board of Tax Appeals sustained the Commissioner in refusing to allow as a deduction for charitable gifts an amount in excess of 15 per centum of the taxpayer's "ordinary net income."

> *Susan Dwight Bliss* v. *Commissioner*, 27 B. T. A. 205 (Dec. 2/32. Overruled by Board of Tax Appeals in *Aaron Straus* v. *Commissioner*, 27 B. T. A. 1116, April 6/33).

On an appeal, the Circuit Court of Appeals for the Second Circuit reversed the decision of the Board of Tax Appeals, holding that the taxpayer was entitled to compute the charitable deduction on the basis of her net income, *including* therein capital net gain.

> *Bliss* v. *Commissioner of Internal Revenue*, 68 Fed. 2nd 890 (C. C. A. 2nd, Jan. 8, 1934).

From the foregoing decision of the Circuit Court of Appeals, the Commissioner has brought the petition with respect to which this brief is filed.

IV

THE STATUTE

The pertinent portions of the Revenue Act of 1928 are as follows:

* * * * * * *

"TITLE I—INCOME TAX

SUBTITLE B—GENERAL PROVISIONS

PART II—COMPUTATION OF NET INCOME

SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions . . .

(*n*) Charitable and Other Contributions. In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

(1) the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(3) the special fund for vocational rehabilitation authorized by Section 7 of the Vocational Rehabilitation Act;

(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) a fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals;

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary. (For unlimited deduction if contributions and gifts exceed 90 per centum of the net income, see Section 120.)" (Italics supplied.)

* * * * * * *

"TITLE I—INCOME TAX
SUBTITLE B—GENERAL PROVISIONS
PART II—COMPUTATION OF NET INCOME

*SEC. 21. NET INCOME. 'Net income' means the gross income computed under Section 22, less the deductions allowed by Section 23.

**SEC. 22. GROSS INCOME. (*a*) General definition. 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, *or sales, or dealings in property,* whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . . . .

(*c*) Determination of Gain or Loss. In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in Sections 111, 112, and 113. . . .

***SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:

(*a*) Expenses .....;
(*b*) Interest .....;
(*c*) Taxes Generally .....;
(*d*) Taxes of Shareholder Paid by Corporation;

* Sec. 21, Act of Cong., May 29, 1928, c. 852; 45 Stat. 797.
** Sec. 22, Act of Cong., May 29, 1928, c. 852; 45 Stat. 797.
*** Sec. 23, Act of Cong., May 29, 1928, c. 852; 45 Stat. 797, 799.

(*c*) Losses by Individuals. In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft.

(*f*) Losses by corporations.....;
(*g*) Basis for determining loss.....;
(*h*) Loss on sale of stock or securities.....;
(*i*) Net Losses .....;
(*j*) Bad debts .....;
(*k*) Depreciation .....;
(*l*) Depletion .....;
(*m*) Basis for depreciation and depletion....;
**(*n*) Charitable and other contributions.....;
(*o*) Future expenses in case of casual sales of real property .....;
(*p*) Dividends received by corporations.....;
(*q*) Pension trusts . . ." (Italics supplied).

* * * * * * *

"TITLE I—INCOME TAX

SUBTITLE C—SUPPLEMENTAL PROVISIONS

(supplementary to Subtitle B, Part I*)

*** SEC. 101. CAPITAL NET GAINS AND LOSSES.

(*a*) Tax in Case of Capital Net Gain. In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

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* "Rates of Tax." ** Quoted above, pp. 4–5.

*** Sec. 101, Act of Cong., May 29, 1928, c. 852; 45 Stat. 797, 811.

(*b*) Tax in Case of Capital Net Loss. In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(*c*) Definitions. For the purposes of this title—

(1) 'Capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) 'Capital loss' means deductible loss resulting from the sale or exchange of capital assets.

(3) 'Capital deductions' means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) 'Ordinary deductions' means the deductions allowed by Section 23 other than capital losses and capital deductions.

(5) 'Capital net gain' means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) 'Capital net loss' means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) 'Ordinary net income' means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) 'Capital assets' means property held by the taxpayer for more than two years (whether or not

connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. For the purposes of this definition—. . . . . .

(*d*) Collection and Payment of Tax. The total tax determined under subsection (*a*) or (*b*) shall be collected and paid in the same manner, at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title."

V

THE ARGUMENT

A.

THE TERM "NET INCOME" AS USED IN SECTION 23(*n*) OF THE REVENUE ACT OF 1928 (THE SECTION LIMITING TO 15 PER CENTUM OF THE TAXPAYER'S "NET INCOME" THE DEDUCTION FOR CHARITABLE GIFTS) MEANS THE NET INCOME AS DEFINED BY SECTIONS 21, 22, AND 23 AND INCLUDES CAPITAL NET GAIN.

It was the uniform administrative practice of the Commissioner of Internal Revenue to allow charitable gifts as deductions to the limit of 15 per centum of the taxpayer's total net income, including capital net gain, from 1921, when the capital net gain provisions were originally adopted, until 1932, when the Commissioner reversed his position.

The argument as to the clear meaning of the term "net income," as used in Section 23(*n*) of the Revenue Act of 1928 (the Section limiting the deduction for charitable gifts to 15 per centum of the taxpayer's "net income"), has been fully and convincingly made in the briefs filed by counsel

for the respondent and by counsel for Aaron Straus, as *amicus curiae*. It would be surplusage to repeat that argument here.

The purpose of this brief is to draw the attention of the Court to an additional consideration, set forth in subsection B below.

B.

EVEN IF IT MIGHT BE THOUGHT GOOD PUBLIC POLICY TO EXCUDE *CAPITAL NET LOSS* IN COMPUTING THE AMOUNT OF THE CHARITABLE DEDUCTION, NEVERTHELESS IT WOULD BE MOST POOR PUBLIC POLICY AND INCONSISTENT WITH THE PURPOSE OF THE REVENUE ACT TO EXCLUDE *CAPITAL NET GAIN* IN COMPUTING THE AMOUNT OF THE CHARITABLE DEDUCTION.

In 1931 the Board of Tax Appeals was called upon to decide whether, in computing the charitable gift deduction under Section 23(*n*) of the 1928 Act, capital net loss should be included in or excluded from "net income."

> *Hallie D. Elkins* v. *Commissioner*, 24 B. T. A. 572 (Nov. 3/31).

This was the first time that the question of the exclusion from "net income" of either capital net loss or capital net gain had been presented to the Board. The Board decided that *capital net loss should be excluded from "net income"* in computing the charitable gift deduction.

This decision was followed by the Board, without substantial comment, in *Charles J. Livingood, Executor* v. *Commissioner*, 25 B. T. A. 585 (Feb. 23/32). These two Board decisions, which never have been followed in any decision of a higher court, were rendered long before the full Board (reversing the prior decisions of single members) held that *capital net gain should be included in "net income"* in computing the charitable gift deduction.

Aaron Straus, Petitioner v. *Commissioner*, 27 B. T. A. 1116 (April 6/33).

In deciding the *Straus* case, the Board stated that "the cases involving capital net losses may or may not be distinguishable from those involving capital net gains. We express no opinion on that subject . . ." (p. 1119).

The Board's decisions in the *Elkins* and *Livingood* cases have focussed attention on the handling of capital net loss in connection with the charitable gifts deduction. From these decisions the thought has arisen that it might be good public policy to allow a taxpayer, in years when he suffers large capital net losses, to retain his charitable gifts deduction unimpaired (*i.e.*, to exclude capital net loss in computing the net income on which said deduction is based). As perhaps a natural consequence of this consideration, some persons may assume that it would not be unreasonable or against public policy to exclude capital net gain in computing such net income. The purpose of this brief is to demonstrate that not to include capital net gain in computing such net income would be, in fact, opposed to public policy and inconsistent with the general theory of the Statute.

In presenting that argument, it is proper to review the sequence of, and the essential reasons for, the statutory provisions relating to the charitable gifts deduction and to capital net gain.

The provision relating to the charitable gifts deduction first appeared in federal revenue legislation in the Revenue Act of 1917.* The reason for the provision may be stated as follows. Congress realized that the higher income tax rates imposed by the new Act upon net income would obviously leave taxpayers with so much less income than in prior years that, unless some deduction was allowed for charitable gifts, taxpayers might curtail or omit their gifts to

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* Revenue Act of 1917, Title XII, sec. 1201 (2); sec. 1201 (2), Act of Cong., October 3, 1917, c. 63; 40 Stat. 300, 330.

charity, thereby threatening the existence of charities and possibly throwing the burden of supporting charities upon the state. To relieve such a situation, the deduction for charitable gifts was permitted. The broad effect of the provision, therefore, was to exempt from income tax income given to charity and allowed to be deducted.

The limitation of the deduction to 15 per centum of the net taxable income, without the deduction, was obviously intended to prevent taxpayers from reducing their taxes by greatly increasing their charitable gifts. It was reasonable to suppose that the average person would not normally give to charity more than 15 per centum of his net taxable income.

Under the Revenue Act* in effect before the introduction in 1921 into federal revenue legislation of capital net gain provisions, there were two classes of net taxable income each subject to different rate of tax, namely, net income subject to both normal and surtax and net income subject to surtax only. Also, of course, different portions of the net income subject to surtax were taxable at differing rates of tax. The charitable gift deduction, however, was allowed to the extent of 15 per centum of all net taxable income of both classes, even though, as a result, such deduction might reduce, by much more than 15 per centum, the net income subject to both the normal and surtax and might offset entirely that portion of the net income subject to the highest rate of surtax. In other words, the taxpayer was allowed to take his deductible charitable gifts out of that part of his taxable income which was subject to the heaviest tax.

The Revenue Act of 1921 first introduced the capital net gain provision.** This provision in effect created, for the purpose of determining the rate of tax, a third class of net taxable income.

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* Revenue Act of 1918; Act of Cong., February 24, 1919, c. 18; 40 Stat. 1057.

** Revenue Act of 1921, sec. 206; sec. 206, Act of Cong., November 23, 1921, c. 136; 42 Stat. 227, 232.

The Government's position is that this third class of net taxable income, which, in the case of persons with very large incomes, may be taxed at a much lower rate than prior to the Revenue Act of 1921, should not be included in figuring the percentage of net taxable income which may be devoted to deductible charitable gifts.

This contention is not reasonable. Prior to 1921 the tax law had allowed the charitable gifts deduction up to 15 per centum of all net taxable income (including profits on sales of securities), however taxed. There was nothing in the capital net gain provisions, as adopted in 1921,* to show that Congress intended to cut down the amount which taxpayers might give to charity free of tax.

Furthermore, it is more reasonable to assume that Congress intended that the charitable gifts deduction of up to 15 per centum of all classes of net taxable income (including capital net gain) should continue to be deductible, as previously, from net income taxable at the highest rate, rather than to assume that Congress intended suddenly (by discontinuing altogether the allowance of 15 per centum of capital net gain) to reduce the charitable deduction.

It may be surmised that the Government would never have suggested that all classes of net taxable income, at whatever rate taxed, should not be included in figuring the 15 per centum limitation for deductible charitable gifts, had it not been for the above-mentioned decision in the *Elkins* case (holding that capital net loss should not be deducted from net taxable income in figuring the allowable amount of deductible charitable gifts).

The *Elkins* decision was probably influenced by public policy. It is desirable that private charities be continuously supported by the gifts of private individuals. Many private individuals desire to continue their charitable gifts in spite of capital losses. They should be encouraged so to do. Accordingly, it would be a desirable thing that they be allowed

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* Revenue Act of 1921, sec. 206; sec. 206, Act of Cong., November 23, 1921, c. 136; 42 Stat. 227, 232.

to deduct charitable gifts up to 15 per centum of their ordinary net income, regardless of their capital losses.

But to say that the result of the *Elkins* decision is in line with a wise public policy and is desirable is not the same thing as to say that the *Elkins* decision is legally correct under the Revenue Act of 1928. Nor is it to say that the rule of the *Elkins* case, which concerned capital net loss, would be, when applied to capital net gain, in line with wise public policy and desirable. In fact, the exact contrary is true.

The idea behind the *Elkins* decision is not reversible. Merely because a person should be encouraged to continue to give to charitable organizations 15 per centum of his ordinary net income in years when he has capital net losses, does not lead to the idea that he should be discouraged from giving to charitable organizations 15 per centum of his capital net gain in years when he has capital net gain. Before the Revenue Act of 1921, he was allowed by statute to deduct 15 per centum of his capital profits (unless diminished by other deductions) and give the same to charity tax-free. If the Government's present contention is sustained, the taxpayer will be deprived of that much of his charitable deduction.

The Government may say that the taxpayer should be deprived thereof, because, in the case of persons with very large incomes, the Revenue Act of 1921 (and subsequent Acts) greatly reduced the tax on capital net gains and so left taxpayers more able than before to make charitable gifts. This is not a valid argument for two reasons.

(1) The theory of the charitable gifts deduction is obviously to afford relief to generously-disposed taxpayers by allowing 15 per centum of their net taxable income to go tax-free to charity and by allowing the amount so given to charity to be deducted from the net income which would otherwise be taxed at the highest rate. Whereas a reduction in the rate of their taxes makes the need of this relief less urgent, it does not do away with the primary need of such relief.

(2) There are many persons of moderate incomes who under the capital net gain provision pay nearly as much tax on their capital net gains as under the other provisions of the law they pay on their ordinary incomes. For them the capital net gain provision is a minor, not a major, relief. Arbitrarily to attach to that relief a provision that they can no longer deduct 15 per centum of capital net gain for charitable gifts would be, through the financial burden on them, a direct interference with the public policy of promoting the continuance of their charitable gifts.

Congress might with some technical logic have adopted a plan of allowing charitable gifts (*a*) to be deducted from fully taxable net income up to 15 per centum of that income, (*b*) to be deducted from net income subject to surtax only up to 15 per centum of that income, and (*c*) to be deducted from capital net gain up to 15 per centum of such capital net gain. Congress might also have divided the deduction between the incomes subject to different rates of surtax. But Congress adopted no such plan. The plan's complication was a good reason weighing against its adoption.

Since such a plan was not adopted, it is much more reasonable to allow charitable gifts up to 15 per centum of net taxable income of all classes to be deducted from the income which would otherwise be taxed at the highest rate (by denying the appeal in this case) than to reduce the amount of the deduction by excluding capital net gain from the net income on which the 15 per centum limitation is figured (by applying to this case of capital net gain the capital net loss doctrine of the *Elkins* case). The latter course would surely defeat the desirable and wise policy of allowing 15 per centum of the net taxable income to flow tax-free to charity in those years in which the taxpayer is most able to make charitable donations.

VI

CONCLUSION

It is respectfully submitted that the term "net income," as used in Section 23 (*n*) of the Revenue Act of 1928, means the total net income subject to tax, as computed before the deduction for charitable gifts, and includes a capital gain.

Furthermore, it is submitted that the inclusion of capital net gain in the "net income" upon which the charitable gifts deduction is computed, is in line with sound public policy and consistent with the purpose of the Revenue Act to foster the support of charity by the contributions of private individuals.

Respectfully submitted,

PHILLIPS KETCHUM,
Counsel for Robert Treat Paine, 2nd.
1 Federal Street,
Boston, Massachusetts.

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CHARLES ELMORE

No. 6

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

v.

SUSAN DWIGHT BLISS

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF AS AMICUS CURIAE
AND
MOTION FOR LEAVE TO FILE SAME

JOHN E. MCCLURE,
920 Southern Building,
Washington, D. C.
Attorney for Leslie T. Igleheart and John L. Igleheart.

Eynon Printing Co., Inc., Washington, D. C.

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ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

May it please the Court:

The undersigned respectfully moves this Honorable Court for leave to file the annexed brief as amicus curiae in the foregoing entitled case. The attorneys for the petitioner and the respondent have stated in writing that they have no objection to the filing of this brief.

JOHN E. MCCLURE,
Attorney for Leslie T. Igleheart and John L. Igleheart.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934

No. 6

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

v.

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ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF ON BEHALF OF LESLIE T. IGLEHEART AND JOHN L. IGLEHEART

The cases of *Commissioner* v. *Leslie T. Igleheart and John L. Igleheart*, of Evansville, Indiana, are pending before the United States Circuit Court of Appeals for the Seventh Circuit. The question involved is whether the basis of computing the 15% deduction allowable for charitable contributions includes capital net gains, or whether it is limited to ordinary net income only. The Board of Tax Appeals decided the question in favor of the taxpayers. *Igleheart* v. *Commissioner*, 27 B. T. A. 1426 (Pet. Br. 20). The decision of this Court in

the Bliss case obviously will be followed by the Seventh Circuit Court of Appeals in the Igleheart cases—at least the Government has brought to the attention of the Judges of that Court the pendency of the Bliss case before this Court, stating that the Court of Appeals for the Seventh Circuit might desire to withhold its decision in the Igleheart cases until the Supreme Court had passed upon the merits in the Bliss case.

ARGUMENT

The crux of the question is the confusion on the part of the petitioner of the term "net income" as defined by Section 21, and the term "ordinary net income" as defined by Section 101(c)(7) of the Revenue Act of 1928. He confuses **ascertainment of net income** with the **computation of taxes on that income** by arguing that Section 101 (a), which sets forth the rates at which certain income may be taxed, is a substitute for Section 21, which defines the net income.

Bearing on this interpretation are two important facts: (a) The provisions for the deductibility of contributions were first in the Revenue Act of 1917, while the provisions as to capital gains and capital losses occurred for the first time in the Revenue Act of 1921. There is nothing to indicate that the introduction into the revenue laws of the capital gain and capital loss provisions af-

fected or was intended to affect in any way the extent to which charitable contributions were allowable as deductions. (b) Under the most recent Act of Congress (Revenue Act of 1934) the 15% provision for contributions clearly applies to capital gains. That is, in the Revenue Act of 1934, Congress, instead of taxing capital gains at rates differing from those rates applicable to ordinary net income, taxes only a percentage of the capital gains at the same rates at which ordinary net income is taxed. **Thus the net income is not split up under the Act of 1934 into "ordinary net income" and "capital gains."** See Section 117, Revenue Act of 1934. In making these changes in the Revenue Act of 1934 from related provisions in prior laws no action was taken by Congress or any of its committees to indicate that a result as curious as that contended for by the Government had previously existed.

It is suggested that a taxpayer who has capital gain is more likely to be the one most able to make contributions to charity, and it is fair to assume that Congress considered such an apparent situation.

ERRONEOUS REASONING BY THE BOARD

The reasoning of the Board near the close of the opinion in *Hallie D. Elkins* v. *Commissioner*, 24 B. T. A. 572, seems to be erroneous. Mrs. Elkins

had a *capital loss* of $127,259.41 and an *ordinary net income* of $113,151.98, exclusive of charitable contributions. The Board reasons as follows:

> "It is untenable to say that for the purpose of computing a tax liability this petitioner has a *net* income of $113,151.98 and that at the same time she has no *net* income for the purpose of computing the amount allowable as a deduction for contributions."

Mrs. Elkins did not have a "net income" of $113,151.98, although the Board so stated in the quoted part above, but she had an "ordinary net income" of that amount. It is apparent that the confusion by the Board of the phrase "net income" and the phrase "ordinary net income" caused the Board to reach an erroneous decision in the Elkins case, which erroneous decision was in effect reversed by the Board itself in the case of *Straus* v. *Commissioner*, 27 B. T. A. 1116.

Respectfully submitted,

JOHN E. MCCLURE,
920 Southern Building,
Washington, D. C.
Attorney for Leslie T. Igleheart and John L. Igleheart.

OPINION

CORRECTED COPY

SUPREME COURT OF THE UNITED STATES.

Nos. 6 and 7.—October Term, 1934.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,
6 *vs.*
Susan Dwight Bliss.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,
7 *vs.*
William Albert Harbison.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[November 5, 1934.]

Mr. Justice Roberts delivered the opinion of the Court.

These cases present the question whether deductions on account of charitable contributions are to be taken from net income as defined by Section 21, or from ordinary net income as defined by Section 101 (c) (7), of the Revenue Act of 1928.[1] Though the deductions claimed and disallowed in the two cases differ in amount, the principle involved is the same in both, and statement of the facts in No. 6 will suffice.

In 1928 respondent had a net income (before any deduction for contributions to charity) of approximately $500,000. Some $211,000 of this was gain from the sale of capital assets, upon which she elected to be taxed at the rate of 12½ per cent. pursuant to Section 101 of the Act. During the year she made charitable contributions, as defined in the statute, to the amount of approximately $44,000. In her return she deducted the amount of the contributions from her total net income. She paid tax on $211,000 of the net income, after the deduction, at the rate of 12½ per cent. and on the balance at normal and surtax rates. The Commissioner of Internal Revenue ruled the respondent could not use the

[1] 45 Stat. 797, 811; U. S. C. Tit. 26, §§ 2021, 2101.

$500,000 of net income as a base on which to calculate the 15 per cent. deduction for charitable contributions, but must first subtract the $211,000 of net gain on sale of capital assets and use only the balance of $289,000 of ordinary net income. A reduction of the allowable deduction for charitable contributions to about $40,000, and a deficiency in tax paid of about $1,000, resulted. The Board of Tax Appeals sustained the Commissioner, but the Circuit Court of Appeals, by a divided court, reversed the Board.[2] We granted certiorari.

For "net income", the base specified in Section 23(n) upon which the 15 per cent. deduction of charitable contributions is to be calculated, the petitioner would substitute "ordinary net income" as defined in Section 101. So to read the Act would violate its plain terms and run counter to the history of the legislation.

The scheme of all the Revenue Acts since that of 1916 has been to sweep all income of every sort, including capital gains, into what is denominated gross income and to authorize certain deductions therefrom in order to arrive at net income,—the base for calculation of the tax. In the Act of October 3, 1917,[3] Congress, in order to encourage gifts to religious, educational and other charitable objects, granted the privilege of deducting such gifts from gross income, but limited the total deduction to 15 per cent. of the taxpayer's net income, calculated in the first instance without reference to the amount of such contributions. All of the later Acts have contained a like provision. The Acts provide that the taxpayer shall first deduct from gross income the total of all permissible deductions save that for contributions, thus arriving at a provisional net income, and then deduct therefrom his contributions, but in no event to an amount greater than fifteen per cent. of the provisional net income. By the last men-

[2] 68 F. (2d) 890. The opinion of the Circuit Court of Appeals in the *Harbison* case is reported 68 F. (2d) 1004. The same result was reached in *White* v. *Atkins*, 69 F. (2d) 960 (C. C. A. 1), and in *Blow* v. *United States*, 5 F. Supp. 737 (D. C. N. D. Ill.). The rulings of the Board of Tax Appeals were at first in accordance with the petitioner's contention: *Elkins* v. *Commissioner*, 24 B. T. A. 572; *Livingood* v. *Commissioner*, 25 B. T. A. 585; and the instant cases, 26 B. T. A. 896; 27 B. T. A. 205 and 506. Subsequently the full Board reached an opposite result in *Straus* v. *Commissioner*, 27 B. T. A. 1116. See also *Robinette* v. *Commissioner*, 27 B. T. A. 1426.

[3] § 1201; 40 Stat. 330.

tioned operation the final net income—the base for calculation of the tax—is ascertained. The relevant sections of the Act of 1928 are typical. They are copied in the margin.[4]

Commencing with the Revenue Act of 1921 Congress, in order to encourage realization of profits on capital assets, saw fit to relieve gain thus derived of the heavy surtaxes then applicable, and to permit the payment of tax at a flat rate of 12½ per cent. on so much of the taxpayer's income as represented the net gain from capital transactions.[5]

The accomplishment of this purpose of applying two rates to two different kinds of net income, required new provisions as to the base for each rate. Section 101 of the Revenue Act of 1928 prescribes the method to be followed. So far as material it is

[4]Part II.—Computation of Net Income.

Sec. 21. Net Income.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

Sec. 22. Gross Income.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

. . . . . .

Sec. 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

. . . . . .

(n) *Charitable and other contributions.*—In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

. . . . . .

(2) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes . . . ,

. . . . . .

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. . . . (45 Stat. 797, 799, 801.)

[5]Revenue Act of 1921, § 206, 42 Stat. 232; Revenue Act of 1924, § 208, 43 Stat. 262; Revenue Act of 1926, § 208, 44 Stat. 19.

set forth in the margin.[6] In extending this relief to taxpayers, Congress might have modified the privilege theretofore existing with respect to charitable contributions, by directing that they should be deducted solely from capital net gain or should be ap-

[6]SUBTITLE C—SUPPLEMENTAL PROVISIONS.

Supplement A—Rates of Tax.

Sec. 101. Capital Net Gains and Losses.

(a) *Tax in case of capital net gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) *Tax in case of capital net loss.*—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) *Definitions.*—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions. (45 Stat. 811; U. S. C. Tit. 26, § 2101.)

portioned and deducted ratably from ordinary net income and from capital net gain. The Acts, however, evince no such purpose. In the Act of 1928, as will be seen by reference to Sections 21, 22 and 23 (*supra* note 4), the statutory concept of net income is preserved. These sections are found in Part II of Title I, which deals with "Computation of Net Income." Section 101, on the other hand, is found under "Supplemental Provisions", and is captioned "Supplement A—Rates of Tax." It is obviously directed to the matter of computation of tax on a portion of net income as defined in Section 21. There is nothing novel in such a division of the statutory net income into parts for the purpose of applying different rates of tax, as witness the provisions fixing the rates on those portions of the entire net income attributable to dividends, earned income, interest on United States obligations, and gains from the sale of mines, and allowing credits for dependents.[7]

The plain requirements of Section 101 are that in ascertaining ordinary net income there shall be excluded from the computation only items of capital gain, capital loss, and capital deductions. Charitable contributions covered by Section 23(n) obviously are not capital deductions as defined by Section 101(c) (3), but on the contrary are "ordinary deductions" within the meaning of Section 101 (c) (4).

By the express words of Section 23(n) charitable contributions are to be deducted ~~from~~ ^ net income as defined in Section 21; and nothing in Section 101, which prescribes merely a method for segregating a portion of that net income for taxation at a special rate, in any wise alters the right of the taxpayer to take the deduction in accordance with Section 23(n).

If the meaning of the Act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed. Nor should the reduction in the rate of tax on capital gain, first granted in the Revenue Act of 1921, be held to circumscribe the privilege granted in the earlier Acts, and retained in later ones,

[7]See Sections 25, 31 and 102 of the Revenue Act of 1928, 45 Stat. 802, 804, 812.

with respect to charitable contributions, unless that result be plainly required by the language used. As has been shown the statutes if read as written lead to a contrary result. Moreover, from 1923 to 1932 the Commissioner uniformly ruled that the deduction for charitable contributions was to be taken from net income before computation of the tax and hence in whole from ordinary net income.[8] The reenactment in later Acts of the sections permitting the deduction indicate Congressional approval of this administrative interpretation.

The judgments are affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

[8]See Corp. Trust Co., Fed. Inc. Tax Service, 1924, Par. 2033; I. T. 2104, Cum. Bull. III-2, p. 152; Mim. 3931, XI-1, C. B. 33.